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Report of the Auditor General of Canada to the House of Commons

1994

VOLUME 9

Chapter 14



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In order to better meet clients' needs, we have changed the format for distribution of our 1994 Report. This year's Report comprises 34 chapters that have been bound, by department, into 17 volumes. The Report is also available in a variety of electronic formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this volume.

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1994 Report of the Auditor General of Canada to the House of Commons

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The audit work reported in this volume was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

Chapter 14

Agriculture and Agri–Food Canada

Farm Income Protection

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Agriculture and Agri–Food Canada

Farm Income Protection

Assistant Auditor General: Don Young
Responsible Auditor: Doug Timmins

Main Points

14.1 A wide range of federal farm income protection programs spanning many decades and Acts of Parliament has been designed and implemented in response to regional or commodity agricultural crises. These programs have involved federal contributions of some $4.5 billion since 1991.

14.2 The 1991 *Farm Income Protection Act* was intended to provide consistent and predictable safety nets, yet the current programs differ considerably from year to year and by commodity and region. This has created geographical "balkanization" and a fragmented approach within the industry.

14.3 We are concerned that the Department of Agriculture and Agri–Food continues to operate programs without a clear consensus on what they are expected to achieve. Since program objectives are not commonly understood and performance is not measured against them, it is difficult for the Department to determine whether or not existing programs are adhering to the social, environmental, production neutrality and equity principles set out in the *Farm Income Protection Act.*

14.4 The Crop Insurance Program is provincially delivered and is required to be self–sustaining. In Saskatchewan, this program has received funding from federal and provincial reinsurance programs to cover a cumulative negative fund balance of $536 million up to 31 March 1994. Since 1991, there has been a 58 percent increase in premiums in an effort to address this problem, while at the same time 20 percent of the producers in the program have withdrawn. Consequently, it is difficult to see how the Saskatchewan program will ever become self–sustaining.

14.5 To finance deficits under the provincial crop insurance programs, the federal government provides advances, as needed, to the provinces participating in the federal Crop Reinsurance Program. The federal Crop Reinsurance Program is also required to be self–sustaining, but in order to achieve this, the terms and conditions of the program would have to be amended. Based on the present contribution rate, it would take about 45 to 50 years for the current Saskatchewan deficit of $346 million to be recovered by the federal government.

14.6 For several years, our audits have reported deficiencies in the Department's financial management and control of these programs. While the Department has responded to many of our observations, deficiencies continue to arise whenever new programs or changes are introduced. For example, when the Net Income Stabilization Account was introduced, deficiencies arose with respect to payment verification.

14.7 Further, as a result of delays in preparing financial statements, annual reports and program evaluations, Parliament has not received all relevant information on these programs on a timely basis.

Introduction

14.8 The completion of a major review of agricultural policy resulted in the passage in April 1991 of the *Farm Income Protection Act*, a revised framework for all federally supported farm safety net programs. Existing Acts were repealed, and five federally and provincially supported price and market insurance programs were established under the new Act. These are:

- Crop Insurance Program – continued as a means of minimizing the economic effects of crop losses caused by uncontrollable natural hazards;

- Revenue Insurance Program – as a means of protecting producers from declines in prices of agricultural commodities;

- Gross Revenue Insurance Program – as a means of minimizing the economic effects resulting from variability in both yield and prices;

- Net Income Stabilization Account – as a means of providing income stabilization by allowing producers to accumulate funds in good years to be used in bad years; and

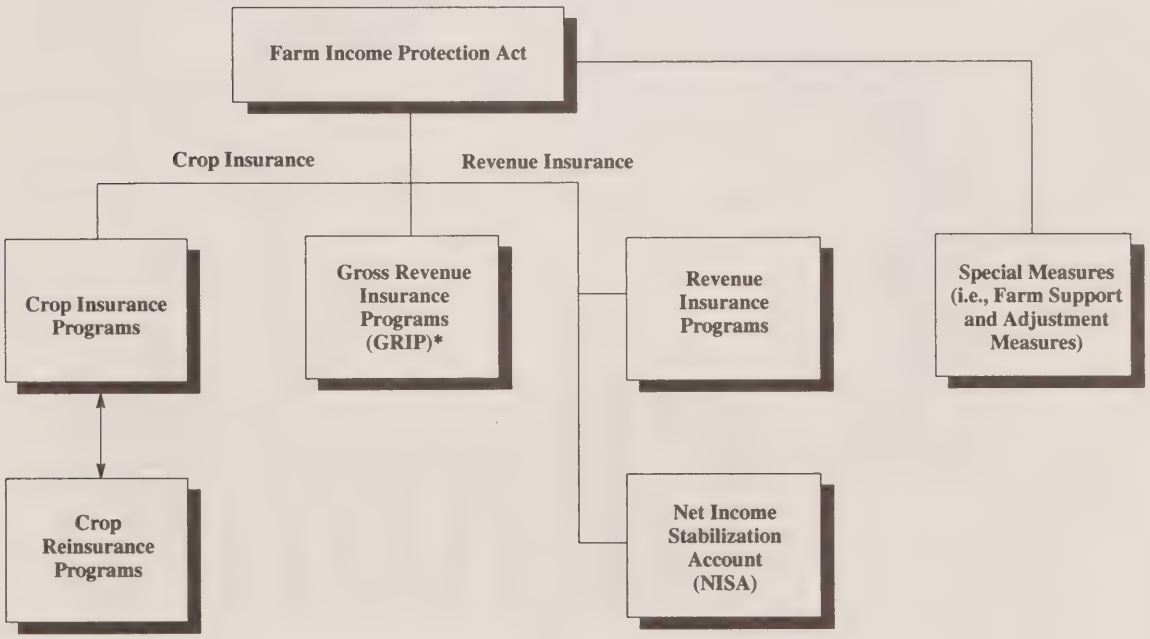
- Special Measures (e.g., Farm Support and Adjustment Measures programs) – as a means of meeting any unforeseen emergency situations that cannot be adequately covered by the other four programs.

14.9 Two ad hoc Farm Support and Adjustment Measures programs, with

A major agricultural review resulted in the passage in April 1991 of the *Farm Income Protection Act*.

Exhibit 14.1

Framework of Federal Farm Income Protection Programs



* Combination program that provides both crop and revenue insurance

Our 1991 audit resulted in the Department's commitment to the Public Accounts Committee for prompt action, which this audit covers.

expenditures of approximately $631 million and $775 million respectively, were implemented in 1991. According to the Department of Agriculture and Agri–Food (Agriculture and Agri–Food Canada), they were meant to be a bridge during the year of transition from the old to the new programs.

14.10 These insurance programs and the Net Income Stabilization Account program are tripartite in nature, and as a result, premiums or contributions are cost–shared by the federal government, the provincial governments and the producers. In addition, deficit financing of the Crop Insurance Program is federally administered through a Crop Reinsurance Program into which the provinces of Saskatchewan, Manitoba, Alberta, New Brunswick and Nova Scotia pay premiums.

14.11 In 1991, we carried out an audit of the farm safety net programs that were in effect before the enactment of the *Farm Income Protection Act*. The goal for the audit was to determine whether management had satisfactory procedures for: a) measuring and reporting on the effectiveness of the existing safety net programs and b) offering reasonable assurance that the programs were subject to proper financial management and control.

14.12 We identified several problems and made a number of recommendations, focussing on "lessons learned" from existing programs that would assist the Department in implementing its new farm safety net structure. The Department agreed with our findings and made a commitment to the Public Accounts Committee for prompt action.

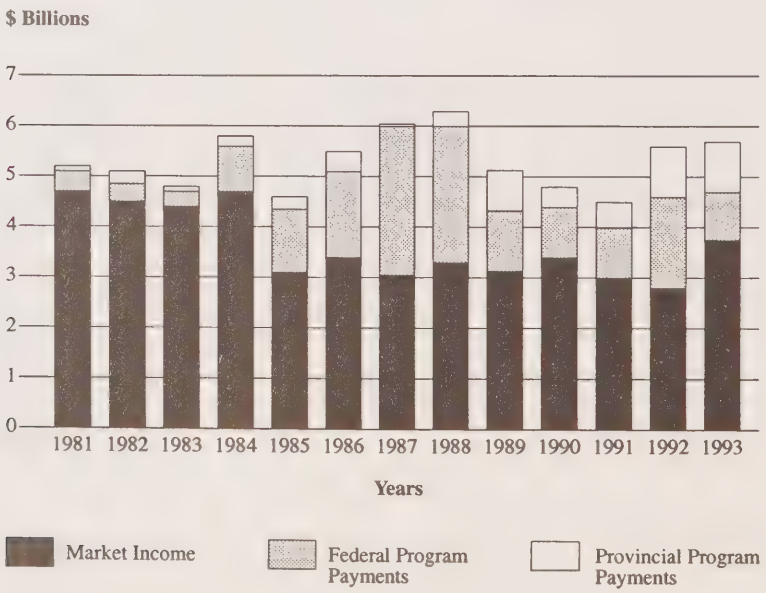
14.13 Normally, we follow up and report on the status of the Department's progress two years after an audit. However, the breadth of changes to the farm safety net structure since 1991 dictated that the follow–up be combined with an audit of the new programs.

Audit Scope and Objectives

14.14 This audit was carried out in the context of:

Exhibit 14.2

Net Cash Farm Income
1981 to 1993



Source: Agriculture and Agri-Food Canada

- the continual creation, extension and dissolution since the 1930s of various programs designed to respond to regional or commodity agricultural crises, and

- questions raised in our 1991 audit about the adequacy of the effectiveness measurement and financial management and control of farm safety net programs.

14.15 The gross federal expenditures on farm safety nets have declined greatly since the mid–1980s. At the same time, the combined effect of decreasing grain market prices and rising costs of production has decreased net cash market income. As shown in Exhibit 14.2, increasing provincial program payments have brought 1993 net cash income to the same level as it was in 1984.

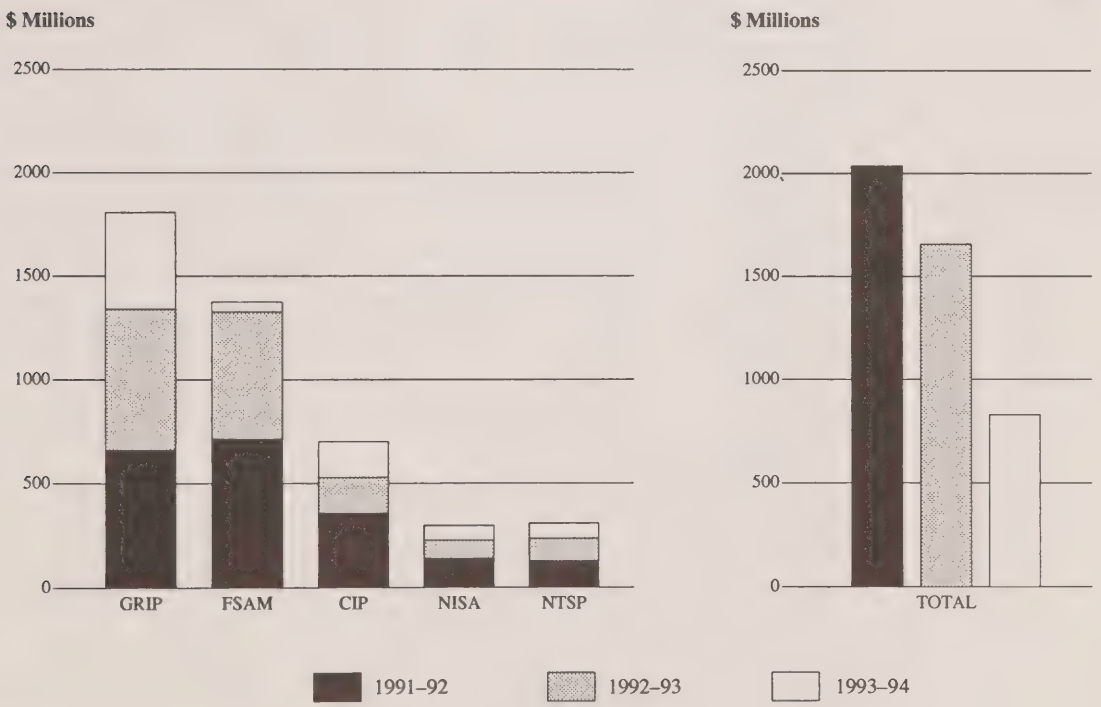
14.16 Exhibit 14.3 shows the ongoing farm income protection programs for 1993–94. These involve federal contributions of some $831 million, bringing the government's support for these programs to a total of some $4.5 billion since our last audit of them in 1991.

14.17 Our audit focusses on current programs for farm income support delivered by the Department under the authority of the *Farm Income Protection*

Our current audit also focusses on the $4.5 billion contributed to the income protection programs since 1991.

Exhibit 14.3

Federal Contributions to Farm Income Protection Programs



GRIP – Gross Revenue Insurance Program
FSAM – Farm Support and Adjustment Measures Program
CIP – Crop Insurance Program
NISA – Net Income Stabilization Account
NTSP – National Tripartite Stabilization Program

Act, as well as the two ad hoc programs, Farm Support and Adjustment Measures I and II. We have excluded from the scope of this audit the dairy subsidy and other minor non–recurring programs under this Act.

Income protection programs span several decades and many Acts of Parliament.

14.18 The objectives of our audit were to assess and report the extent to which management has:

- designed programs with clear, consistent and commonly understood objectives to address identified farm income priorities;
- established systems to measure and report on the effectiveness of these programs;
- obtained reasonable assurance that the programs are subject to proper financial management and control; and
- taken corrective action in response to our 1991 farm safety net observations and recommendations.

Background

Evolution of Farm Income Protection Programs

14.19 The range of federal yield and revenue income protection programs available to Canadian farmers spans several decades and many Acts of Parliament (shown in Exhibit 14.4).

14.20 **Crop insurance.** A series of crop losses in Western Canada prompted the 1939 enactment of the *Prairie Farm Assistance Act*. The Act, since repealed, provided for the creation of a fund to compensate for crop losses through a percentage levy on grain sales. Indemnity payments were issued to all farmers in a given township on the basis of the average grain yield.

Exhibit 14.4

Chronology of *Farm Income Protection Act* and Programs

1939	***Prairie Farm Assistance Act*** provided financial assistance for losses due to low grain yield on a township basis. A percentage levy was imposed on sales.
1944	***Agricultural Prices Support Act*** was implemented as a temporary vehicle for post–war commodity stabilization.
1958	***Agricultural Stabilization Act*** named nine commodities whose prices would be held at a prescribed minimum level.
1959	***Crop Insurance Act*** allowed for the contribution of funds to provincial schemes based on premiums paid by farmers – in essence, sharing provincial risk.
1975	***Agricultural Stabilization Act*** was amended to provide for cost sharing, either federal–producer or federal–provincial–producer.
1976	***Western Grain Stabilization Act*** established a fund based on contributions from all Western grain and oilseed farmers and the federal government to protect against falling prices and rising costs.
1986	Under the ***Agricultural Stabilization Act***, the National Tripartite Stabilization Program was created to provide commodity–based price insurance, with the federal and provincial governments and producers paying equal premium contributions.
1991	***Farm Income Protection Act*** authorizes agreements between the federal and provincial governments to protect the gross revenue, net income, price and yield of producers of agricultural products.

14.21 The *Crop Insurance Act* was introduced in 1959 to address the demands of farmers for individual crop protection. This Act was repealed in 1991, and its provisions were incorporated into the *Farm Income Protection Act* introduced at that time. The crop insurance programs are provincially delivered and are required to be self–sustaining. The federal Crop Reinsurance Program is also required to be self–sustaining.

14.22 **Revenue insurance.** The *Agricultural Prices Support Act* was enacted in 1944 as a temporary and transitional vehicle for post–war commodity stability. In the latter part of the 1950s, downward pressures on prices spurred the emergence of permanent safety net programs in agriculture. The *Agricultural Prices Support Act* was replaced in 1958 by the *Agricultural Stabilization Act*, which reflected a desire for a more precise statutory commitment.

14.23 The high inflation during the 1970s led to the amendment in 1975 of the payment formula in the *Agricultural Stabilization Act* to include coverage for current cash costs of production. In the following year, 1976, the *Western Grain Stabilization Act* was introduced to protect Western grain farmers against falling prices and rising costs.

14.24 By the mid–1980s, the globalization of markets and changing trade rules had forced a recognition that truly national solutions were needed. In 1986, in an attempt to limit competition among provinces in the provision of support to agriculture, the National Tripartite Stabilization Program was created.

14.25 In the late 1980s, the Department admitted that there were problems associated with the *Agricultural Stabilization Act* and the *Western Grain Stabilization Act* and stated that the programs under these Acts lacked predictability for farmers to make good management decisions and did not allow the public purse to target individual needs. The Agri–Food Policy Review in 1989 resulted in proposals for comprehensive and predictable federal–provincial farm safety net programs.

14.26 New legislation was written, and the *Farm Income Protection Act* passed into law in April 1991. Under the Act, a provincially administered Gross Revenue Insurance Program was implemented to supplement the existing commodity price and yield programs — the Crop Insurance Program and the Revenue Insurance Program. This combined program incorporates the protection of crop insurance and revenue insurance. Only the Maritimes have adopted the combined program. In the other provinces, producers are able to enrol in either the Revenue Insurance Program or the Crop Insurance Program, or in both. Only if they enrol in both do they have the coverage equivalent to the Gross Revenue Insurance Program. In addition, a federally administered Net Income Stabilization Account was established to allow farmers to accumulate funds for the bad years.

Audit Observations and Recommendations

Continuing Change in the Stabilization Programs

14.27 Subsequent to a major policy review and the enactment of the *Farm Income Protection Act*, we would have expected the ongoing farm income stabilization programs to provide a stability and predictability that would

allow for long–range planning by the farmers and the Department.

14.28 In 1989, the Department identified inequities between commodities and regions as one of the key problems with the safety net programs. Support levels, program financing, eligibility and risk coverage varied from one region to another and from one commodity to another.

14.29 This fragmented commodity approach stemmed from the fact that safety nets were created originally as temporary measures dealing only with the commodity or region in difficulty at the time. As later crises and emergencies arose, some of these measures became permanent.

The conceptual thrust of the *Farm Income Protection Act* is to provide consistent and predictable safety nets, yet the components of the current programs continue to vary.

14.30 Commodity interest groups and the provinces have historically had a basket of program options from which to select. In an attempt to minimize this variation, section 4 (2) (b) was incorporated into the *Farm Income Protection Act*. It states that consideration shall be given to the following:

> "The level of protection to be provided by, and the relative share of governmental contributions to be provided to, the program in relation to particular agricultural products or classes of products should be equitable and reasonably consistent with all other agreements, taking into account regional diversity."

14.31 While the conceptual thrust of the *Farm Income Protection Act* is to provide consistent and predictable safety nets, the components of current programs continue to vary from year to year and by commodity and region.

14.32 As its title indicates, the Gross Revenue Insurance Program was initially intended to provide full revenue protection by combining the yield protection of crop insurance with price protection. The shift to the Gross Revenue Insurance Program was meant to be a move away from separate commodity plan administration and central federal accounting to a national agreement with provincially administered accounts. This objective has been accomplished. The provinces now administer the revenue insurance component of the Gross Revenue Insurance Program.

14.33 The method of calculating Gross Revenue Insurance Program payments varies across the country, such that identical situations in bordering provinces can result in completely different stabilization payments, depending on coverage levels, ways of offsetting losses, yield adjustments, limits on acreage coverage and whether protection is determined on an area basis or an individual basis. Moreover, not all crops grown in a province are eligible for protection.

14.34 One of the concepts of the Gross Revenue Insurance Program was that offsets would be put in place to ensure that there was no overlapping of the benefits from crop insurance. As a transitional measure for 1991–92, the Gross Revenue Insurance Program agreement provided for partial relief from this requirement. We found however, that only the Maritime provinces have instituted full offsets. As a result, producers in most provinces are in a position to receive benefits greater than originally intended.

14.35 Moreover, the program design changed during the process leading up to and following the enactment of the *Farm Income Protection Act*. As early as 1990, the Department had recognized that an independent Revenue Insurance Program was less acceptable to international trading partners than a combined Gross

Revenue Insurance Program. However, the concept of combining yield and price protection into one holistic approach exists today only in the Maritime provinces. An integrated Gross Revenue Insurance Program does not exist in the other provinces. As a result, the separation of yield and price into two separate programs parallels the situation that existed under the *Agricultural Stabilization Act* and the *Crop Insurance Act*.

14.36 The Department continues to have to negotiate, design and alter programs in response to a wide range of expectations and pressures from individuals, commodity organizations and provincial authorities, some of whom are partners in the programs. The federal–provincial sharing of agricultural jurisdiction and administrative responsibilities and the involvement of about 300 other organizations, many of which are large and influential and have conflicting demands, place additional pressures on program management.

14.37 For instance, most of the National Tripartite Stabilization Program commodity plans are being terminated and replaced with transitional programs, or commodities are becoming immediately eligible under the Net Income Stabilization Account Program and/or the Gross Revenue Insurance Program. As shown in Exhibit 14.5, the number of plans has dropped from 69 to 9, but a provincial and commodity patchwork of the National Tripartite Stabilization Program will continue in 1995.

14.38 While the *Farm Income Protection Act* is national, the differences in provincial application and the continuation of distinct commodity programs have resulted in "balkanization" geographically and by producer groups within the industry. The Net Income Stabilization Account program is a move to a more national approach; however, not

Differences in provincial application and the continuation of distinct commodity programs have resulted in "balkanization" geographically and by producer group within the industry.

Exhibit 14.5

National Tripartite Stabilization Program – Summary of Provincial Activity by Plan

	Number of Provincial Plans in 1991	Number of Provincial Plans in 1995
Sugar Beets	2	2
Apples	5	3
Honey	8	1
Onions	4	0
White Pea Beans	2	0
Kidney and Cranberry Beans	3	1
Other Coloured Beans	4	2
Hogs	9	0
Lambs	8	0
Slaughter Cattle	8	0
Feeder Cattle	8	0
Cow/Calf	8	0
TOTAL	**69**	**9**

all commodities are eligible. As a result, the "nationality" of these programs is drawn into question.

Program Objectives Still Need to Be Commonly Understood and Accepted by All Parties

14.39 Program objectives that allow for different interpretations may have been necessary initially to encourage cost sharing and facilitate producer enrolment. However, in order to achieve their vision of federal–provincial whole–farm programs that meet the needs of the industry and individual producers, the Department, the provinces and the producers must develop common concepts and translate their shared understanding into clear, consistent and measurable program objectives and a joint action plan. When formulating these objectives, stakeholders need to consider the increased administrative complexity, compliance procedures and costs associated with managing programs that target individuals.

In order to achieve their vision of federal–provincial whole–farm programs, the Department, the provinces and the producers must develop common concepts and translate their shared understanding into a joint action plan.

14.40 The Department agreed with, but only partially acted upon, our 1991 recommendation that the socio–economic performance objectives for the individual safety net programs be defined in operational terms. This is not an easy task, as evident in the case of the federal–provincial Crop Reinsurance Program, where, despite efforts, no consensus on program objectives has been reached. Nevertheless, we are concerned that programs costing hundreds of millions of dollars each year continue to operate with no definitive or accepted statement of what they are expected to achieve.

14.41 The recent General Agreement on Tariffs and Trade more clearly establishes the rules of international commodity marketing. The agreement has reduced external constraints on the Department, provinces and producers that were hindering the development of a comprehensive vision for farm income protection programs.

14.42 The Department should take the lead role in clearly defining farm income protection program objectives that are commonly understood and accepted by the provinces and industry. A joint action plan to achieve these objectives should be developed.

Department's response: *The Department has already taken the lead and has been working with the provinces and the industry to develop farm income protection program objectives and the action plans to achieve these objectives. The National Safety Nets Consultation Committee is currently working on objectives, principles and alternatives for the future. This is a long–term process that will evolve with continued discussions and negotiation with sector representatives and will be supported by the continued development of measures on the performance of safety net programs.*

Ongoing Effectiveness Information Not Available

14.43 In addition to translating the broad financial and socio–economic objectives of each program into clear, consistent and measurable statements, the five broad principles of the *Farm Income Protection Act* need to be expressed in operational terms.

14.44 The principles stated in the Act are as follows:

- All programs should be production– and market–neutral so that farmers will adjust to market signals.
- The level of protection under each agreement should be consistent among all

agreements, and the treatment of all classes of products should be equitable.

- Programs should encourage the long–term social and economic stability of farm families and communities.

- Programs should recognize the need for future changes that may emanate from Canada's evolving international obligations under the General Agreement on Tariffs and Trade, the North American Free Trade Agreement or other similar trade agreements, and should remain compatible with these obligations.

- In their design and operation, programs should reflect Canada's commitment to environmental sustainability. Programs should also reflect economic sustainability aims by promoting initiatives that are efficient, self–sustaining over time and conducive to the agricultural sector's long–term development.

14.45 Late in 1992, the Department reported to the Public Accounts Committee that it was undergoing a review of its operational planning framework that would help it to identify new indicators and objectives and develop targets for the farm income protection programs. In June 1993, the Department issued a revised operational planning framework. This framework is intended to provide direction for internal and external audiences, as well as to establish targets. It is also meant to provide Parliament with a mechanism for determining whether or not program results are consistent with the purposes for which resources have been appropriated.

14.46 Some financial self–sustainability and economic performance targets have been established for the farm income protection programs, including the following:

- Income of insured producers is to be greater than non–insured producers over time.

- Program insurance contracts are to be accepted as security by financial institutions.

- Trends in farm income over time are to show a decline in special assistance payments.

- Program revenue is to match program expenditure over time (i.e., program is to be self–sustainable).

14.47 The targets remain to be set for the social, environmental, production neutrality, equity and consistency principles stated in the *Farm Income Protection Act*.

14.48 Objectives based on economic principles can often be achieved only at the expense of social concerns. One of the challenges in managing these programs is to balance the five stated principles, which sometimes compete against each other. The establishment of specific sub–objectives and targets is vital, not only to provide a basis for program design and accountability, but also so that appropriate data can be collected cost–effectively and made available for ongoing management decision making and trade negotiations. This data will be essential for the report on the programs, which must, under the *Farm Income Protection Act*, be tabled in the House of Commons by 1 April 1996.

The establishment of specific sub–objectives and targets is vital.

14.49 In 1991, Treasury Board approved 27 additional person–years to collect and analyze farm–level data to determine the financial and management impact of government programs. In 1994, three years later, in spite of the fact that farm–level profiles have been published, the Department still has more to do to implement all the necessary systems to gather and analyze information on income protection program results. For instance,

at the time of our audit, the Department had not yet collected the farm income data on an insured producer versus non–insured producer basis or confirmed financial institutions' acceptance of government insurance contracts as security.

14.50 Since program objectives are not commonly applied and performance is not measured against them, it is difficult for the Department to determine whether existing programs are actually adhering to the broad principles set out in the *Farm Income Protection Act.*

14.51 The Department should prepare a comprehensive list of performance indicators for all the principles established under the *Farm Income Protection Act.* It should measure and report the achievement of results to Parliament and to other interested parties.

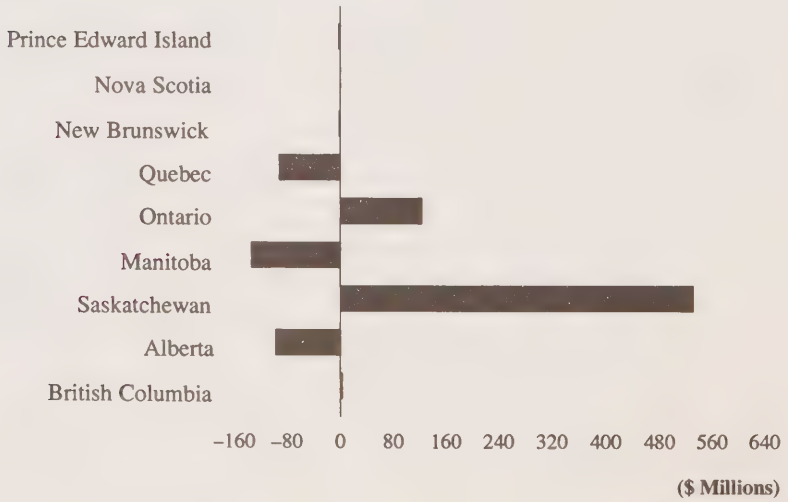
Department's response: *The Department has constructed a major farm level data base, which has been a valuable tool in: providing analysis of the potential impacts on farm income and industry competitiveness; providing analysis of proposed policy changes; considering new proposals for farm income protection; assessing the effectiveness of current programs; and working towards a consensus on program objectives. The Department will continue to utilize and develop this data base to analyze trend lines and measure the performance of programs to develop a consensus on program objectives.*

Financial Self–sustainability Issues Persist

14.52 The Gross Revenue Insurance Program, the Crop Insurance Program and the Revenue Insurance Program are required to be self–sustaining. Setting this financial objective implies that, over time, premiums and government contributions together should match the amount paid to farmers. However, at any time, a provincial account may be in a cumulative surplus or deficit situation. A surplus indicates the existence of a reserve to address the risk of major losses in future years; a deficit indicates that cumulative indemnities have exceeded cumulative premiums.

Exhibit 14.6

Gross Revenue Insurance Cumulative Fund Balance (forecasted until the end of 1994–95)



Source: Agriculture and Agri–Food Canada

14.53 The Department forecasts a cumulative surplus of over $530 million in the Saskatchewan Gross Revenue Insurance Program account for the end of 1994–95. Saskatchewan has given notice that it plans to terminate its participation in the Gross Revenue Insurance Program after the 1994 crop year and distribute the surplus among the federal and provincial governments and producers. The province has established a committee to develop and review alternatives for establishing a new program starting with a zero balance.

14.54 Saskatchewan has indicated that it wishes to remain in the Crop Insurance Program, where it had an estimated cumulative negative fund balance of $536 million up to 31 March 1994.

14.55 The present Saskatchewan Crop Insurance deficit began accumulating in 1988 at the time of drought conditions that resulted in very severe and widespread crop losses in Western Canada. Absorption by the federal government of any portion of the deficit that farmers are unlikely ever to repay would be inconsistent with the requirement of the *Farm Income Protection Act* that premiums be sufficient to allow the program to be self–sustaining.

14.56 Exhibits 14.6 and 14.7 show some cumulative deficit and surplus figures by province for the Gross Revenue Insurance Program and the Crop Insurance Program. These figures provide some indication of the extent to which they are self–sustainable.

14.57 Crop Insurance Program. The Farm Income Protection Regulations respecting the Crop Insurance Program require that each provincially administered program provide, no later than 1 April 1993 and every five years thereafter, signed actuarial certificates attesting to the fact that each plan is actuarially sound. Further, the program is required to be financially self–sustaining at the provincial level.

14.58 The Department obtained the services of an actuarial firm to provide advice on premium rate methodology and to provide definitions of the terms "self–sustaining" and "actuarially sound". In August 1992, the firm's reports were provided as guidelines to all provinces to incorporate into their premium rate methodology.

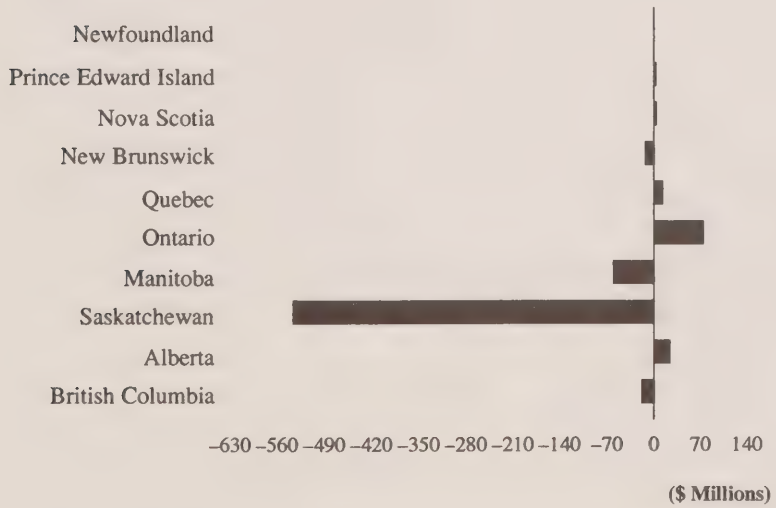


Exhibit 14.7

Provincial Crop Insurance Cumulative Fund Balance

Source: Agriculture and Agri–Food Canada

Between 1991 and 1993, Saskatchewan farmers withdrew over 4 million insured acres from the Crop Insurance Program.

14.59 In response to our 1991 recommendation that the term "self–sustaining" be defined, the following parameters were established to ensure that self–sustainability is measured in a consistent and professional way.

- As a general rule, 10 to 20 years is an acceptable range for obtaining the target reserve level.

- The actuarial analysis should have a confidence level of 90–95 percent that actual experience would not deviate significantly from expected loss or gain.

- The time period for determining actuarially sound premium rates is 20 years or more of historical experience.

14.60 A second benefit of the guidelines was that they provided the Department with consistent provincial responses for analysis and assessment. Each provincial crop insurance actuary, with the exception of Saskatchewan's, certified that the premiums charged were proper in relation to the expected costs and contained an adequate margin to meet the self–sustaining requirement established by law. Saskatchewan's actuary certified only the methodology. He did not certify whether premiums charged would result in self–sustainability.

14.61 According to the Department, up to 31 March 1994, the Saskatchewan Crop Insurance Program had received funding from federal and provincial reinsurance programs for most of the $536 million cumulative deficiency in revenue compared to indemnities paid out, and had a cumulative loss ratio of 1.20. This ratio indicates that cumulative loss payouts have exceeded cumulative premiums and government contributions by 20 percent and that the provincial program has accumulated a deficiency of $200,000 for every $1 million in premiums that it collected.

14.62 The Saskatchewan actuarial report indicates that an increase in the existing annual premium is required for the program to become self–sustainable according to the departmental definition. The report recognized that raising premiums 10 to 15 percent to meet this requirement would result in excess surpluses over the long term, and therefore recommended an increase of 8 percent of the existing annual premium as being sufficient.

14.63 Due to several factors, the insurance premium in Saskatchewan rose from an average of $6.17 per acre in 1991 to $9.79 per acre in 1993. This helped to reduce the cumulative loss ratio from 1.28 to 1.20. However, during the same period, approximately 20 percent or 10,000 of the farmers in Saskatchewan withdrew over 4 million insured acres from the Crop Insurance Program. If farmers continue to withdraw at this rate, it is difficult to see how the Saskatchewan program will become self–sustaining. According to the Department, there is no evidence or agreement with the province that the reduction in participation is due to the increase in premiums. Furthermore, there is limited analysis of the causes of the problem. Nevertheless, premiums have been increased in an attempt to save the program. It is recognized that the current requirement for programs under the *Farm Income Protection Act* to be self–sustaining limits the options that management has to deal with the current deficit situation.

14.64 A significant number of Saskatchewan farmers may now be assuming an increased financial risk by not insuring in the hope that the federal

government would provide funding if an extreme crop loss situation were to arise.

14.65 The Department, in conjunction with the Province of Saskatchewan, should determine the causes for the withdrawal of such a large number of Saskatchewan farmers from the Crop Insurance Program and take action to correct the problem.

Department's response: *The Department agrees with the recommendation. A Federal/Provincial Steering Committee and Working Group have been set up to carry out the required work.*

Participation stabilized in 1994, and it should be noted that the participation level in Saskatchewan currently is equivalent to participation in the neighbouring Prairie provinces.

14.66 Crop Reinsurance Program. The five provinces participating in the Crop Reinsurance Program may draw advances when they do not have sufficient cash to meet the payments to farmers under the provincially delivered Crop Insurance Program. Under the reinsurance agreement, an annual maximum of 15 percent of total crop insurance premiums in each province is contributed to the federal reinsurance fund. If provincial insurance premium reserves are insufficient to pay all indemnities, federal reinsurance makes up a portion of the shortfall.

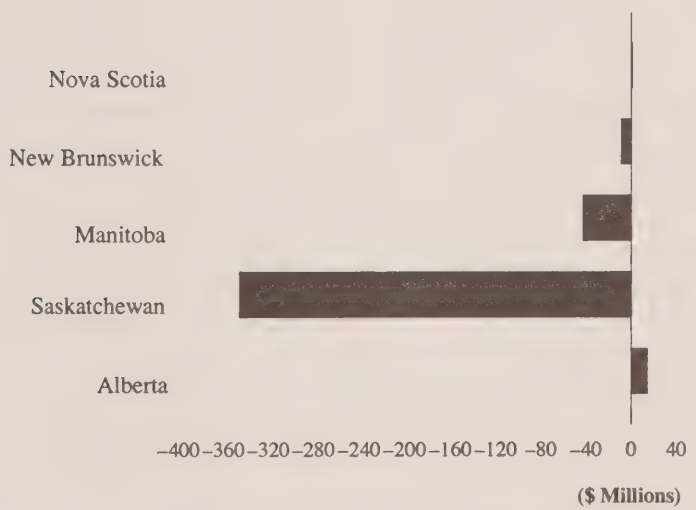
14.67 As at 31 March 1994, the Saskatchewan Crop Reinsurance Fund deficit was forecasted to be $346 million or 91 percent of the total federal Crop Reinsurance Program deficit and represents most of the deficit under this province's Crop Insurance Program (see Exhibit 14.8).

14.68 In 1993, the Department of Agriculture and Agri–Food initiated a review of the federal Crop Reinsurance Program. All provinces were invited to participate in the review; seven did so. According to the Department, three provinces did not participate because of the failure to reach a federal–provincial consensus on what the objectives of the program should be. The provinces that did participate believed that the program should be continued as a strictly federal–provincial financing arrangement or modified to a repayment arrangement that considers risk.

14.69 The actuarial report estimated that in the case of Saskatchewan, it would

Exhibit 14.8

Federal Crop Reinsurance Cumulative Fund Balance by Province



Source: Agriculture and Agri–Food Canada

take about 45 to 50 years for the federal government to recover the amounts advanced to cover the deficit. This assumes that the required rate increases could be passed on without losing a large proportion of the insured population. This report concluded that the federal–provincial reinsurance provisions do not meet the Department's minimum guidelines for self–sustainability.

In the case of Saskatchewan, it would take about 45 to 50 years for the federal government to recover the amounts advanced under the Crop Reinsurance Program.

14.70 The maximum contribution limit of 15 percent of total provincial premiums coupled with provincial program deficits indicates that there is a need to amend the Crop Reinsurance Program terms and conditions.

14.71 The Department should renegotiate and amend the terms and conditions governing the Crop Reinsurance Program to ensure that the premiums levied are sufficient to allow the program to be self–sustaining.

Department's response: *The Department agrees with the recommendation and in fact had contracted an independent consulting actuary in 1993 to review reinsurance and to recommend changes if required. The Department is currently reviewing the actuary's report to formulate its position on his recommendations. The Department will be developing a workplan for federal/provincial consultation aimed at negotiating changes to reinsurance.*

Some Financial Management and Control Deficiencies Have Been Addressed While Others Continue

14.72 The passage of the *Farm Income Protection Act* was the result of a period of intense restructuring of federal–provincial farm safety net programs. As we noted in 1991, this effort of negotiation and mediation was at the cost of efficient program administration.

14.73 Our agricultural audits from 1986 to the present have reported numerous deficiencies in the Department's financial management and control over programs. In our 1991 audit report and subsequent management letter, we reiterated the urgent need for the Department to deal with this area. We also expected the Department to address these previously reported deficiencies in the development of new programs. While the Department has responded to many of our previous observations, as new programs or changes to programs are introduced, financial management and control deficiencies continue to arise.

Two ad hoc programs provided financial incentives during the transition period

14.74 Even under the best of circumstances, implementation of new agricultural programs would have been difficult, costly and time–consuming. Yet, in the midst of this change, two additional ad hoc programs had to be dealt with. These temporary programs were to provide financial aid until the new programs under the Act were fully in effect.

14.75 The Department states that to help farmers make the transition to the new Gross Revenue Insurance Program and the Net Income Stabilization Account, Farm Support and Adjustment Measures I, the first of the two ad hoc programs, was announced in April of 1991. Approximately $631 million was expended, with $293 million directed towards encouraging participation in the Net Income Stabilization Account. The Account is effectively a fund established for financially difficult years, with withdrawals triggered by a formula. During the first year, the Net Income Stabilization Account transitional provisions waived the established payment

trigger requirements and allowed producers to determine how much to withdraw. In the second year, producers could make this same choice for Farm Support and Adjustment Measures money only.

14.76 In October of 1991, the government announced a second program, Farm Support and Adjustment Measures II, to further supplement farmers' income. Budgeted at $800 million, the second Farm Support and Adjustment Measure expended $775 million. Some of the money paid was based upon the Net Income Stabilization Account data for administrative convenience, but it was not intended to encourage participation in the regular Net Income Stabilization Account program.

Administration deficiencies hampered implementation of the Net Income Stabilization Account

14.77 The intent of the Net Income Stabilization Account program established in 1991 was to set up a fund that farmers could put money into in prosperous years for use in financially difficult years. An annual contribution of two percent of eligible net sales up to $250,000 is permitted. The federal and provincial governments together match this contribution and provide interest.

14.78 When the Department originally sought approval of funding for the Net Income Stabilization Account, Treasury Board authorized 70 full–time equivalent positions for the program, with annual operating and capital budgets totalling $12 million. However, the program employed 353 full–time equivalents in 1993–94 and had expenses of $24.5 million, which included $5.8 million relating to a new informatics system.

14.79 Producers pay a $40 administrative fee to cover part of the cost of administering their accounts. In 1993–94, the revenue collected by the Net Income Stabilization Account amounted to $8.9 million, resulting in net administration costs to the Department of $15.6 million.

14.80 With the passage of the *Farm Income Protection Act* in April 1991, the Department was required to quickly develop and administer the new Net Income Stabilization Account program. The program was implemented retroactive to the 1990 taxation year, but the national agreement for the Net Income Stabilization Account was signed only in October 1991. Processing of forms could not be carried out with certainty before this time.

14.81 Because the Net Income Stabilization Account implementation began before the program design was finalized and because of the large volume of producer applications, problems were encountered in delivering the program. A total of 270,000 application forms was sent to producers at the inception of the program. However, sixteen policy changes were negotiated within the first nine months of the Net Income Stabilization Account implementation; consequently, an additional 170,000 forms had to be sent to producers to amend original applications.

14.82 The old forms – some being 27 pages in length with several additional pages of schedules – were seen by many farmers as being too long and complicated, particularly in light of the small amounts of money involved. The farmer's average net deposit in 1992 was $1,531, while the average net withdrawal was $1,443. We found that 75 percent of the Net Income Stabilization Account forms were completed by accounting

The intent of the Net Income Stabilization Account program was to set up a fund that farmers could put money into in prosperous years for use in financially difficult years.

Net Income Stabilization Account implementation began before the program design was finalized, and problems were encountered in delivering the program.

Further analysis is needed to assess why 51,109 producers have no balance in their Net Income Stabilization Account.

firms in 1991, the only year this statistic was recorded. The Department has since recognized the problems with the forms and has simplified them by reducing them to four pages.

14.83 Presently, the average active account balance for producers is $2,682. Our review of unaudited 1992 data on the Net Income Stabilization Account found that 51,109 producers or 39 percent of participants who received payments have no balance in their account. The Department is aware of many of the reasons for these withdrawals. However, further analysis is needed to assess the extent to which withdrawals have been triggered by market conditions that are viewed as temporary. This analysis may identify producer groups who are not able to put money aside now to protect themselves against future financial difficulties, as intended by the program.

14.84 The Net Income Stabilization Account also faced numerous difficulties with its original computer system. Now obsolete, this system cost $8 million to develop. The system difficulties have contributed to the inability to produce, as yet, financial statements for the first three years of operations. An estimated $10 million is being spent on developing a new accounting, processing and management information system. We did not test this system, as it was not fully operational at the time of our audit. The Department feels that this new system will result in positive changes. Nevertheless, it is still uncertain when the first set of audited financial statements of the Account will be issued, since data are still being reconciled from the first Net Income Stabilization Account system to the departmental financial systems.

14.85 The extent of problems with the Net Income Stabilization Account prompted the Department to conduct an internal audit to provide an evaluation of its control techniques and to assess the accuracy of payments to a very limited sample of producers for the 1990 taxation year. This internal audit concluded that major deficiencies existed even in the fundamental financial management controls. For example, there was no verification of the accuracy and validity of



A large volume of Net Income Stabilization Account application forms was received (see paragraph 14.81).

data provided by producers, and there was an almost complete lack of payment verification. Subsequent work by the Net Income Stabilization Account staff on an extensive sample of large claims revealed that 10 percent of the files reviewed for 1990 were in error and had resulted in net underpayments of $500,000. The Department is of the opinion that the data base is relatively accurate, and no material discrepancies have been found.

14.86 Some of the control weaknesses noted in the report have been addressed in the design of the new computer system. Features in the new system to enhance control include: improved password security, automated interest calculations, exception reports, annual producer statements and confirmations, and cross–referencing of partnership accounts. The effectiveness of these procedures could not be verified at the time of our audit. With the implementation of the new system, the Department believes that improvements in both operations and service to clients will be achieved.

14.87 The internal audit also recommended that desk audits and on–farm inspections be carried out. A desk–audit function was established in December 1993. An accounting firm conducted 200 field audits, and 300 more are planned for the coming year. The Department is also completing negotiations to have Revenue Canada conduct field audits on its behalf at the same time as tax audits are carried out.

14.88 Another intent of the program was to ensure accuracy of claims by matching them with taxation records. For this reason, the *Farm Income Protection Act* required participants in the Net Income Stabilization Account to provide their social insurance number. Indeed, the forms issued for use by producers require that information filed with Revenue Canada be entered, adjusted and reconciled for Net Income Stabilization Account purposes. In the current year, the Department of Agriculture and Agri–Food received information from Revenue Canada on participants who have not filed for tax purposes or who have reported higher sales to Agriculture and Agri–Food than to Revenue Canada. Both bodies are working toward a more efficient method of data transfer and workload identification, which may involve producers filing with Revenue Canada in order to input Net Income Stabilization Account data through the tax system.

The first set of audited financial statements of the Account has still not been issued.

14.89 The Department of Agriculture and Agri–Food prepared and issued tax information slips (AGR–1) to producers for farm support payments for the first time in 1993. The Department subsequently determined that, in some cases, these tax slips showed widespread discrepancies between the Net Income Stabilization Account records and the producer records. The Department indicated that the discrepancies were a result of the producers' lack of understanding of the tax treatment resulting from the practice of "deeming of deposits" and programming errors in preparing the tax slips. Deeming of deposits is used for administrative efficiency. This means that rather than receiving a cheque from a producer for deposit and then issuing a cheque to the producer for withdrawal, a cheque for the net amount is issued to the producers. The gross amount is reportable for tax purposes and is required to be included on tax information slips.

The Department feels that its new control system will result in positive changes.

14.90 To minimize incorrect tax filing by producers, the Department advised producers in March 1994 to use either the tax information slip or their own records, whichever they felt was correct for tax purposes. The Department also advised

producers that the new system would rectify these problems for future years. In order to determine the extent of the problem, the Department indicated that it is performing a reconciliation of information with the objective of issuing detailed producer statements starting from the 1991 tax year.

14.91 The Department should ensure that, for the Net Income Stabilization Account:

- **payments made to producers are verified for accuracy, and action is taken to correct errors found;**
- **recently introduced desk audits and on–site inspections using established procedures are conducted on an ongoing basis;**
- **information submitted by producers is subject to reconciliation and matching to Revenue Canada records;**
- **the reasons for withdrawals are analyzed to determine the extent to which long–term benefits are being achieved; and**
- **financial statements for all prior years are prepared and audited as soon as possible.**

Department's response: *The Department agrees with these recommendations and in fact has already taken action to ensure the recommendations are implemented:*

- *The new NISA accounting, processing and management information system has enhanced procedures, edits and verification to ensure the accuracy of payments made and the correction of any errors identified;*
- *Five hundred desk audits and three hundred on–site inspections, using established procedures, are scheduled for completion during 1994–95;*
- *Processes are currently in place to regularly reconcile and match information submitted by producers with Revenue Canada records and to follow up on any material variances identified;*
- *Withdrawal information will be compiled and presented in the NISA annual report together with audited financial statements. This information will be used to determine program effectiveness in the five–year review of the program.*

Monitoring of provincial administration and payment authorization is in place

14.92 In 1991, we noted that the Department was unaware of serious administrative and compliance problems in the provincial administration of programs. We also observed that officials in the Department approved federal contributions to the Crop Insurance Program and the National Tripartite Stabilization Program without sufficient and appropriate evidence that the provinces had complied with the terms and conditions of the respective agreements.

14.93 The Department responded by staffing and integrating into program operations a separate audit unit, a senior comptrollership position, an assistant comptroller and four financial officers. Their activities include:

- issuing accounting policies and disclosure requirements for financial statements issued by the provinces;
- processing claims, and analyzing and monitoring provincial financial activities;
- developing and implementing standard procedures for reviewing and processing provincial claims; and
- auditing all provincial Gross Revenue Insurance and Crop Insurance administrations and selected National Tripartite Stabilization Program plans in

The Department now has a better understanding of each province's ability to manage the farm income protection programs.

every province, and following up on audit results.

14.94 As a result of these efforts, the Department has a better understanding of each province's ability to manage the farm income protection programs. The Department has recognized that it must verify provincial claims. Today, procedures specify that where additional provincial information is required or a compliance deviation is noted, an appropriate amount of funds is withheld until the matter is resolved. As a result of our recommendation in 1991, new procedures of monitoring and analyzing provincial submissions were implemented. Consequently, over $121 million in provincial Gross Revenue Insurance and Crop Insurance claims have been deemed to be ineligible for federal cost sharing. Approximately another $98 million has been temporarily withheld from the provinces, pending provision of appropriate supporting information, authorization of premium rates or the signing of the agreements.

Vague agreements have been partially corrected

14.95 Dissolution of program agreements and settlement of accounts. Over the next few years, the Department will be faced with the withdrawal of provinces from programs as well as the termination of many of the National Tripartite Stabilization Program plans. For instance, most of the twelve Program plans and the Saskatchewan Gross Revenue Insurance Program have been terminated, are in the process of being terminated or are slated for termination.

14.96 National Tripartite Stabilization Program plans for two commodities — white pea beans and sugar beets — were terminated respectively in July 1992 and August 1993, since they were considered no longer financially self–sustaining. These plans terminated with respective deficits of $44.5 million and $8.4 million and cumulative loss ratios of 2.45 and 1.21. The plan for lambs also terminated in February 1994 with a deficit of $3.7 million and a cumulative loss ratio of 1.56.

14.97 Large surpluses exist in most other plans, and overall the plans had a surplus of almost $103 million as of 31 March 1994, but the deficits in individual plans cannot be offset against surpluses in other plans. This is due in part to the fact that each plan maintains its own account, most plans involve different producers and each plan is directed by its own committee, comprised of federal–provincial representatives and producers.

14.98 The relative split of deficits and surpluses among the three partners — federal and provincial governments and producers — is spelled out in the agreements. In the case of a National Tripartite Stabilization Program plan terminating in a deficit position, the federal and provincial governments are jointly responsible for the total amount.

14.99 The fund is split equally among the federal–provincial–producer partners on termination of a plan with a surplus. However, individual producer entitlement rights are not spelled out with respect to inactive participants at the time of termination of the plan. As each plan is managed separately, individual management committees of each National Tripartite Stabilization Program plan develop their own criteria for the distribution of surplus funds. Compounding this variation, as a province withdraws, it applies its own interpretation to determine who should receive benefits. A similar situation is occurring with respect to Saskatchewan's withdrawal

Clear and complete specifications in agreements are essential to manage the programs properly.

The entitlement rights of individual producers that withdraw from the plan are not spelled out.

from the Gross Revenue Insurance Program. Consequently, individual entitlements vary by plan and by province.

14.100 The Department, in consultation with the provinces and producers, should agree to standard procedures to be employed when provinces withdraw or when plans/agreements are terminated in surplus and deficit situations. These procedures should be an integral part of each federal–provincial agreement.

Department's response: *At the earliest opportunity, the Department will review the wording of the various safety net program agreements to ensure that procedures are clear as to the treatment of surpluses and deficits. Given the diversity of the existing and possibly future safety net programs, it is not clear whether it would be advantageous to have a standard set of procedures applicable to all programs. However, the procedures outlined in agreements themselves should be clearer to avoid any misunderstanding on termination.*

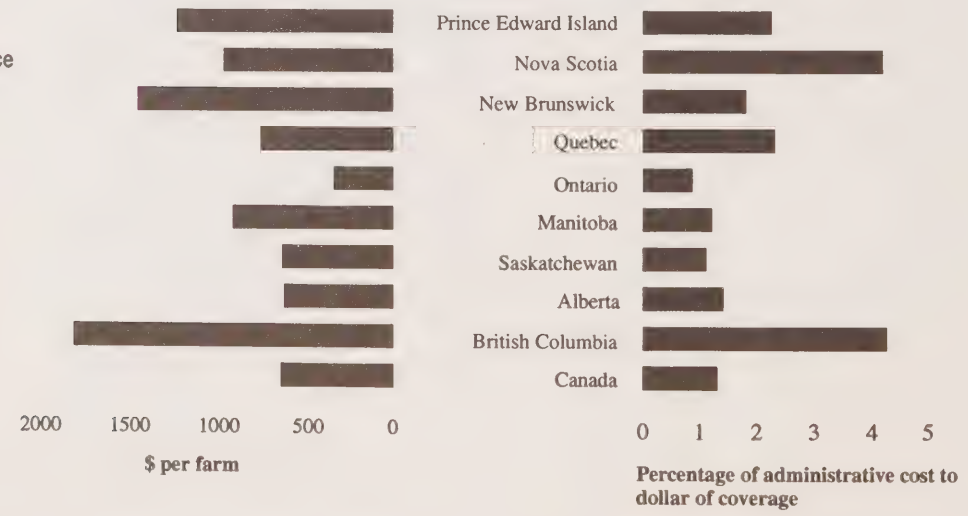
14.101 Federal–provincial administrative agreement. In 1991, we observed that the draft administrative Gross Revenue Insurance Program and Crop Insurance Program agreements providing the terms and conditions under which the federal government would pay 50 percent of the provincial program operating costs were so vague that wide variations in interpretation — with potentially significant financial effects — were possible. Departmental officials stated that they shared our concern and worked to redraft these documents more precisely.

14.102 The federal 50 percent share of the provincial administrative costs for both Crop Insurance and Gross Revenue Insurance was approximately $54 million and $47 million for 1991–92 and 1992–93 respectively.

14.103 The signed federal–provincial administrative agreement is clearer than the draft agreement. However, the agreement allows individual provinces to determine program resourcing and levels of service to be provided. As a result, there are large differences among provincial administrative costs. For example, in 1993–94, the federal 50 percent contribution to provincial administration costs for the Gross

Exhibit 14.9

1993–94 Gross Revenue Insurance and Crop Insurance Administration Costs



Source: Agriculture and Agri–Food Canada

Revenue Insurance Program and the Crop Insurance Program varied across nine of the provinces from less than one percent to more than four percent of every dollar of insurance coverage and from approximately $300 to $1,700 per farm (see Exhibit 14.9). This variation in administrative costs is impacted by the number of producers enrolled in the smaller provincial programs.

14.104 The Department has conducted audits of the provincial administrations, focussing on what it believes to be the high–risk areas, such as accuracy of accounts and verification of yields. It is reasonable to expect some variation across the provinces due to economies of scale. To ensure that the provinces are effectively administering the programs, guidelines need to be developed to deal with the high–risk areas. Where the provincial administrative procedures do not meet the guidelines, federal contributions could be reduced.

14.105 Other administrative arrangements are not clearly spelled out. For instance, the agreement with the provinces stipulates that the federal government may have access to provincial information. Nevertheless, the provinces have flexibility as to the quantity, quality or capability of informatics purchasing and development decisions. Consequently, data obtained from the provinces by the federal government are not always provided in a standard format and, as a result, have to be re–keyed in certain cases.

14.106 The Department, in conjunction with the provinces, should consider establishing guidelines for provincial program management and level of service for future agreements.

Department's response: *The insurance program administration can vary by region and province due to the coverage area and the diversity in agriculture across the country. These variations impact on administration costs, since it is necessary to adapt to the specifics of each provincial program. Thus far the Department has focussed on the areas that are more significant and risky and has already taken or will take the following action:*

- *development of producer yield verification procedures and objectives;*
- *development of an automated management reporting information system for the Crop Insurance and Gross Revenue Insurance programs; and*
- *development of a list with provinces of "best practices" in key areas to improve the efficiency and effectiveness of these programs.*

Timely Reporting Still Not Achieved

14.107 No annual reports have been issued to Parliament respecting the operations or payments made under the federal–provincial agreements as required by Section 21 of the *Farm Income Protection Act*. The Department argues that it provides sufficient information on the operations of programs in its Part III of the Estimates. Notwithstanding this, the 1994–95 Part III does not provide statements on program results as related to the principles of the *Farm Income Protection Act*, cumulative Gross Revenue Insurance Program balances, or complete and audited information on the Net Income Stabilization Account. Furthermore, information is dispersed throughout the Part IIIs of the Estimates, whereas an annual report would consolidate program information in one document.

The Department has responded positively to our 1991 recommendation regarding the completeness and accuracy of financial information.

14.108 The Department indicated that it may use section 157 of the *Financial*

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Chapter 15

Atomic Energy Control Board

Canada's Nuclear Regulator

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Atomic Energy Control Board

Canada's Nuclear Regulator

Assistant Auditor General: Maria Barrados
Responsible Auditor: Ellen Shillabeer

Main Points

15.1 Although the peaceful use of nuclear energy provides potential benefits, it can also involve serious potential hazards through radiation exposure. The Atomic Energy Control Board (AECB) provides Canadians with assurance that the nuclear industry operates in a safe manner. Independent studies have provided additional assurance that the nuclear power reactors are being operated safely.

15.2 In the past decade, the setting in which the AECB regulates the nuclear industry has undergone major changes, presenting significant and difficult challenges to the regulation of nuclear power in Canada.

15.3 The 1946 *Atomic Energy Control Act* requires updating to reflect current circumstances. The weaknesses in the current Act have contributed to some of the deficiencies we observed.

15.4 However, new legislation by itself will not correct the deficiencies identified in the management processes and practices. In those areas we examined, we found that the AECB is not fully meeting its obligations as a regulatory body. Although almost all the licensees and other stakeholders contacted expressed a high degree of respect for the technical competence of AECB staff, significant improvements are needed in a number of its key management processes and practices.

15.5 The AECB needs a clearly documented regulatory strategy, a strategic plan, better documentation of its regulatory requirements, and development of criteria for assessing compliance. In addition, the management of compliance inspection and enforcement activities related to prescribed substances and radioisotopes needs to be significantly strengthened.

15.6 In these changing and difficult times, even greater vigilance is required if the AECB is to continue to provide assurance that the industry remains safe. In our opinion, without updated legislation and improvements in its management processes and practices, the AECB will be hindered in its ability to provide such assurance.

Background

Mandate

15.7 The Atomic Energy Control Board (AECB) was established under the 1946 *Atomic Energy Control (AEC) Act* to control and supervise the development, application and use of nuclear (atomic) energy. The AECB was also created to enable Canada to participate effectively in measures for the international control of nuclear energy.

15.8 The AECB is an independent regulatory body reporting to Parliament through a designated minister, currently the Minister of Natural Resources (formerly Energy, Mines and Resources). To fulfil its mandate, the AECB is granted broad powers under the *AEC Act* for making and enforcing regulations in the nuclear field. The AECB is also a departmental corporation named in Schedule II of the *Financial Administration Act*.

Mission

15.9 As Canada's nuclear regulator, the AECB maintains regulatory control over the use of nuclear energy. This control covers the following:

- nuclear power and research reactors;
- uranium mines and mills;
- uranium refining and conversion facilities;
- fuel fabrication facilities;
- heavy water production plants;
- particle accelerators;
- radioactive waste management facilities;
- prescribed substances (as defined in the *AEC Act* and AEC Regulations); and
- radioisotopes.

15.10 The mission of the AECB is to ensure that the use of nuclear energy in Canada does not pose undue risk to health, safety, security and the environment.

The mission of the AECB is to ensure that the use of nuclear energy in Canada does not pose undue risk to health, safety, security and the environment.

15.11 The AECB achieves its mission through a comprehensive licensing system that covers all aspects of nuclear facilities, equipment, radioactive materials (except some of those that occur naturally) and prescribed substances, including the certification of domestic and foreign transport package designs. The licensing system is administered with the co-operation of other federal and provincial departments in such areas as health, environment, transport and labour.

Organization Structure and Resources

15.12 In accordance with the *AEC Act*, a five–member Board is appointed by the Governor in Council. One member is appointed President of the Board and serves as the only full–time member. The President is also the Chief Executive Officer of the AECB and, as such, supervises and directs the work of the organization. The Board currently meets about 10 times each year.

15.13 Under the *AEC Act*, the Board is ultimately responsible and accountable for the regulation of the nuclear industry in Canada. Within its mandate, the Board has the power to make rules for regulating its proceedings and the performance of its functions.

15.14 Pursuant to the *AEC Act*, the Board has made several sets of regulations, with the approval of the Governor in Council, and has established a comprehensive licensing system. The Board itself makes licensing decisions on about 100 major nuclear facilities, including nuclear power reactors, research

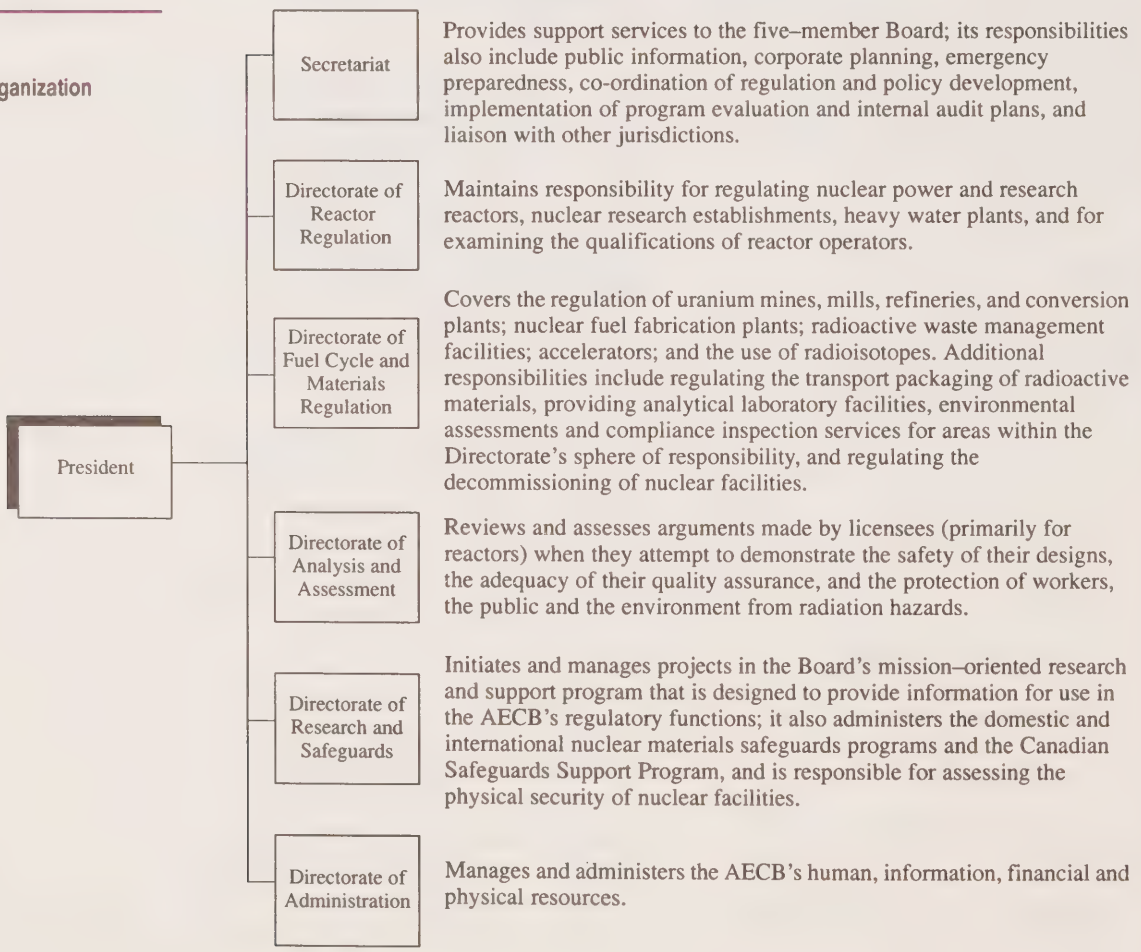
reactors and uranium mines, when it satisfies itself that the use of nuclear technology in the enterprise is safe enough. The licensing system for those facilities examines siting, design, construction, operation, and decommissioning through scientific and engineering review and assessment, compliance inspection and enforcement. Other licensing decisions, notably those pertaining to radioisotope licences, have been delegated by the Board to designated AECB officers.

15.15 The AECB staff implement the policies of the Board and make recommendations to the Board concerning the issuing of licences, and other regulatory matters. They are organized into five Directorates and one Secretariat, as described in Exhibit 15.1.

15.16 For the 1993–94 fiscal year, the AECB had an authorized establishment of 420 full–time equivalents (person–years). It had expenditures of approximately $44.7 million and revenue of about $24.2 million, obtained mostly through its cost–recovery program. Despite the relatively small size of the AECB, its nuclear regulatory responsibilities cause it to have a significant influence on major licensees with assets totalling in the tens of billions of dollars, as well as on about 3,700 smaller licensees.

Exhibit 15.1

AECB Staff Organization



Major Changes Since Our 1985 Audit

15.17 In our 1985 audit, we examined the management controls and administrative procedures connected with the AECB's licensing, inspection and enforcement activities. In our 1987 follow–up audit, we reported that the AECB had responded positively to our 1985 recommendations and was making progress in implementing them.

15.18 Since our 1985 audit, there have been many new pressures placed on the AECB and on its licensees. These pressures include federal regulatory reform, the introduction of cost recovery, the addition of significant numbers of new AECB staff, a worsening economic climate, age–related failures in the nuclear power plants, and increased expectations for protecting the environment, which include more rigorous procedures required by the Environmental Assessment and Review Process Guidelines Order. There is also additional pressure on regulators to be able to demonstrate in a court of law that they have fulfilled all their basic regulatory obligations.

15.19 Regulatory reform has resulted in increased pressure to:

- reduce the number of federal regulations;
- identify and reduce any unnecessary duplication of regulations;
- consult with interested parties both within and outside government before regulatory proposals are put forward for Governor in Council approval; and
- assess fully the benefits and costs of regulations.

15.20 This regulatory reform has been further encouraged over the past decade by the reduction of barriers restricting international trade. The movement toward more open borders and the development of regional trading blocks have prompted governments around the world to reassess policies that decrease the competitiveness of domestic industries.

15.21 Federal regulators are also being asked to "regulate smarter". Managers must now demonstrate that, for existing regulatory programs and substantive new or amended regulations, regulation is the best alternative. Alternatives to regulation include information campaigns to educate those at risk, the development of voluntary standards supported by industry and the public, persuasion, and self–regulation.

15.22 Several changes have led to increased tension in the relationship between the AECB and those it regulates. As part of a government initiative, the AECB introduced fees in April 1990 to recover most of its regulatory operating costs, with a few specified exceptions. Most of those regulated must now pay for the cost of their own regulation.

15.23 Coincidental with the introduction of fees, AECB staff levels began to increase significantly. This has led to licensee concerns about their inability to control regulatory costs, concerns that are compounded by the impact of the prolonged recession. This concern also increases the likelihood that the licensees will demand more justification of any new regulatory requirements.

15.24 As a result of AECB staff increases and the absence of proposals for new nuclear power plants, the AECB can devote more attention to the existing plants in such areas as preventive maintenance, consideration of retro–fitting requirements and encouraging the resolution of outstanding generic safety issues. AECB staff have also been able to

The setting in which the AECB regulates the nuclear industry has undergone major changes since our 1985 audit.

conduct more detailed reviews of a wide variety of nuclear regulatory issues. The nuclear utilities believe that there has been an escalation of regulatory requirements and expectations, both in terms of what must be done and in the time frame for implementation, all at a time of tightening budgets.

15.25 In recent years, a number of key and long–service employees have left the organization, taking with them a wealth of experience and knowledge. This puts pressure on the AECB to find ways to preserve its corporate memory and to train new staff.

15.26 In the nine years since our last audit, the older nuclear power reactor units have shown an increasing frequency of age–related failures, which are expected to result in a growing number of problems. Deterioration of pressure tubes as well as boiler tubes and their supporting structures continues to pose significant technical challenges.

15.27 There has also been increased government emphasis on protecting the environment. The AECB, given its mission, has been involved in numerous environmental assessment hearings over the last five years, including those associated with uranium mines. The AECB will also be involved in similar hearings when the environmental impact statement for disposal of used nuclear fuel is submitted for review to a federal environmental review panel.

15.28 Recent trends in judicial decisions have underlined the importance of rationally allocating available human, financial and physical resources for regulatory activities. Many regulatory inspection and enforcement activities are now considered fully open to judicial scrutiny where civil damages are alleged to have been caused, in whole or in part, by careless enforcement. Although the courts recognize that resources are finite, a regulator who can show the courts that it has reasonably allocated its resources reduces the risk of being found negligent.

15.29 Thus the setting in which the AECB regulates the nuclear industry has undergone major changes since our 1985 audit. These changes present some significant and difficult challenges to the fulfilment of the AECB's regulatory obligations.

Audit Scope, Objective and Criteria

Focus of This Audit

15.30 In planning for the audit, we met with a number of licensees and other stakeholders as well as AECB senior management and all members of the Board. As a result of this work, we chose to focus our audit on the following aspects of AECB's regulatory program, which are important to the fulfilment of its mandate:

- the legislative base;
- the regulatory framework;
- regulatory approaches to compliance and enforcement;
- management of interfaces with other jurisdictions;
- strategic planning, roles and responsibilities;
- human resource requirements;
- program evaluation and internal audit; and
- reporting mechanisms.

15.31 The scientific and engineering review activities and the assessment function were not included in the audit scope, but they too form an important part of the AECB's regulatory program. They

provide information that the Board uses to satisfy itself that a facility or an enterprise using radioactive materials is designed and operated safely.

15.32 We also conducted further follow–up on our observations and recommendations of 1985 and 1987.

Audit Objective and Criteria

15.33 In the areas subject to examination, our audit objective was to assess whether the AECB was fulfilling its obligations as a regulatory body.

15.34 In Exhibit 15.2, we identify a number of key management systems that we consider necessary for a regulatory body with a mandate involving safety. Efficient and effective management also requires:

- a sound strategic plan that links programs and services to a regulatory strategy and provides a framework for resource determination;
- an effective management organization, in which roles, responsibilities and accountabilities are clear to all, and resources required are

Exhibit 15.2

Management Systems Necessary for a Regulatory Body with a Mandate Involving Safety

In order to be efficient and effective, a regulatory body must have in place the following key management systems:

1. **up–to–date legislation** to provide a clear basis for its regulatory activities. Where this is not adequate, the regulator should bring its concerns to the attention of the Minister and Parliament.
2. a **regulatory strategy** that defines such aspects as:
   - the degree of prescriptiveness desired;
   - the mix of legal instruments available, such as regulations and licence conditions;
   - the basis for determining the extent and depth of the regulator's work, such as the risk posed by the enterprise, the level of safety sought and the competence of the licensee;
   - the manner and extent to which the regulator assesses the competence of licensees and their staff;
   - the scientific and engineering review and assessment policy – as elaborated upon in item 4 below (an area not covered by this audit); and
   - the compliance inspection and enforcement policy – as elaborated upon in item 5 below.
3. **regulatory requirements** that are developed and promulgated in a timely manner, and include input from stakeholders and an assessment of whether the benefits outweigh the costs (in compliance with the Treasury Board Regulatory Policy).
4. effective implementation of the **scientific and engineering review and assessment function** in accordance with clearly defined standards and with the level of risk avoidance sought, addressing subject areas such as those noted in item 5 below.
5. effective implementation of the **compliance inspection and enforcement function**, addressing such subject areas as:
   - appropriate policies and procedures for compliance inspection and enforcement to satisfy itself that regulatory requirements are systematically applied for each type of licence and that licensees are treated in a consistent manner;
   - implementation and use of suitable enforcement tools;
   - identification of inspection priorities as well as the nature of its audit role and the frequency of inspection coverage;
   - training of regulator's staff;
   - education of licensees to satisfy itself that they are fully aware of the regulator's requirements;
   - assessing the competence of licensees; and
   - follow–up of inspection deficiencies.
6. effective **management of interfaces** with other federal and provincial jurisdictions, including other regulatory bodies, to reduce the regulatory burden on taxpayers and licensees.
7. **assessment of effectiveness** of regulatory strategies.

defined, obtained and allocated to areas of greatest need;

- management oversight to provide assurance that performance is being appropriately managed. Such mechanisms involve evaluations, audits and other assurance tools; and

- reporting mechanisms to Parliament and the public that provide meaningful information on performance.

Observations and Recommendations

Legislation Respecting the AECB Requires Updating

15.35 An important element in enabling a regulator to carry out its activities in an efficient and effective manner is having in place up–to–date legislation to provide a clear basis for its regulatory activities.

It is important that changes to the current *Atomic Energy Control Act* be considered by Parliament.

15.36 The legislative framework within which the AECB exercises regulatory control was established in 1946 by the *Atomic Energy Control (AEC) Act*. The Act has remained basically unchanged since that time. Its primary focus is on security of nuclear materials, not on health and safety. In 1978, a bill (Bill C–14) proposing a revised version of the Act died on the order paper when Parliament was prorogued.

15.37 Over the past two decades, weaknesses in the current *AEC Act* have been identified by various commissions and studies. These include two parliamentary committees, two ministerial reviews and other independent studies or commissions. They noted that these weaknesses have had an effect on the AECB's ability to discharge its mandate. Areas that need attention include:

- the lack of clear authority to establish and enforce national standards for health, safety, security and the protection of the environment with respect to the use of nuclear energy in Canada;

- the absence of any requirement for financial guarantees for the decommissioning of nuclear facilities (retiring permanently a facility at the end of its service or operational life) and the disposal of nuclear materials;

- the inability of the AECB to take or order remedial action in case of an unacceptable hazardous situation, if there is no licence; and

- the need to bring the powers of compliance inspectors and the penalties for infractions in line with other environmental legislation or practices.

15.38 At the time of the audit, new legislation was being considered. The AECB expects that the new legislation will set the stage for fundamental improvements in nuclear regulation. Currently, limited improvements can be made only through the periodic addition, deletion and amendment of regulations. In our opinion, it is important that changes to the current *AEC Act* be considered by Parliament. However, new legislation by itself will not correct the deficiencies in management processes and practices noted in this audit.

Making available an appropriate range of enforcement tools

15.39 To encourage compliance with its regulatory requirements, the AECB has a number of tools that it can use. The enforcement tool applied depends, in large part, on the seriousness of the infraction and whether there have been repeated infractions. Non–punitive tools could include education, persuasion, warnings and directives.

15.40 Where non–punitive enforcement tools do not achieve the desired results, or where there are serious infractions, the

AECB may amend, suspend or revoke a licence or refuse to issue or renew a licence. These latter courses of action can have a significant financial impact on licensees. For example, suspending or revoking a licence for a nuclear power plant may cost the operator over $250,000 per day in replacement power. Suspending or revoking a licence for a smaller licensee is equally serious as it could mean a loss of livelihood to the licensee and its staff. As a result, suspending or revoking a licence is an enforcement tool that is rarely used.

15.41 The AECB may also seek to prosecute under the *AEC Act* or AEC Regulations. For prescribed substances and radioisotopes, we noted that, during the two–year period April 1991 to March 1993, there were about 2,900 violations of the AEC Regulations or licence conditions that could have directly affected radiation safety. During that same period, a total of 21 individuals and prescribed substance and radioisotope licensees were taken to court. Eighteen cases were successfully prosecuted for a total of $22,400 in fines. The cost of prosecution and investigation during this period exceeded $750,000. These costs represent a major impediment to prosecuting more licensees and individuals who violate the regulations and licence conditions.

15.42 In our opinion, the AECB does not have an appropriate range of enforcement tools to encourage compliance. The maximum penalty permitted under the existing *AEC Act* is a $10,000 fine or five years imprisonment or both. This is not in line with other jurisdictions where environmental legislation and practices may require polluters to pay for damaging the environment with fines up to $1 million. The Act does not provide for any other administrative fines or "tickets" for failure to comply with the AECB's regulatory requirements.

15.43 The limited provisions in the current Act hinder AECB's ability to enforce compliance with its regulations and licence conditions.

A case for financial guarantees

15.44 The *AEC Act* does not give the AECB explicit authority to require financial guarantees for the decommissioning of nuclear facilities or for the disposal of nuclear materials, such as uranium mine tailings, waste from refining of uranium, and used nuclear fuel. Such guarantees could ensure that funds will be available when needed and that the financial burden will not pass to the Crown.

15.45 The absence of any regulatory financial guarantee requirements raises important questions. For example, if there is no licensee or identifiable owner, or if the licensee is unable or unwilling to pay, who then will pay for:

- building and operating permanent disposal facilities for both low–level radioactive waste and used nuclear fuel?
- transportation of waste to the disposal facilities?
- restoration of storage sites? and
- long–term institutional care of storage sites for uranium mine tailings?

15.46 We noted that the federal government has accepted financial responsibility for the long–term management and disposal of historic low–level radioactive waste. Historic waste is generally defined as waste that was previously managed in a manner no longer considered acceptable but for which the original producer can no longer reasonably be held responsible. This waste is largely the result of the radium

The AECB reports that, in Canada, there have been no accidents with reactors or radioactive materials causing detectable public harm.

industry and the early uranium production in the 1930s and 1940s in the Port Hope, Ontario area.

15.47 The AECB proposes to include in its new legislation explicit authority to call for financial guarantees from licensees for the decommissioning of all nuclear facilities and the disposal of nuclear materials. At the same time, legislative authority will be sought to recover from responsible parties the costs of decontamination and other remedial action. The AECB had earlier recognized, in Bill C–14, the need to address the question of financial responsibility in the conditions that could be attached to a site approval or licence. However, Bill C–14 died on the order paper in 1978.

15.48 In our opinion, when public safety is at stake and the dollar amounts at risk are potentially great, the government should take steps to protect the interests of taxpayers. The absence of an appropriate amendment to the *AEC Act* to empower the AECB to require financial guarantees prolongs the uncertainty about who will pay for storage or disposal of nuclear waste, should there be any default on the part of those responsible for the waste.

Licensees and stakeholders expressed a high degree of respect for the dedication, professionalism and technical competence of the AECB staff.

Providing Assurance on the Safety of Canada's Nuclear Industry

15.49 The peaceful use of nuclear energy brings with it benefits as well as risks that have to be properly controlled. The Canadian approach to nuclear regulation is based on the principle that it is the user or licensee who has the primary responsibility for safety. The role of the AECB is to set the appropriate safety standards that must be met by the licensee or applicant and to satisfy itself, through a variety of compliance and assessment mechanisms, that the standards are met.

15.50 As Canada's nuclear regulator, the AECB provides assurance on the safety of the Canadian nuclear industry. New licensees must satisfy the AECB that their proposed operations will comply with AECB regulatory requirements and will be operated in a safe manner, before being granted a licence. These licences are usually issued for a period of two years. Through various processes, including compliance inspection and ongoing assessments and reviews, the AECB satisfies itself that the continuing operations remain safe. The AECB provides further assurance that the licensee is operating in a safe manner through its licence renewal process.

15.51 This assurance depends to a large degree on the technical competence of the AECB staff and the commitment to safety by the licensees. Almost all licensees and other stakeholders contacted during the audit expressed a high degree of respect for the dedication, professionalism and technical competence of the AECB staff.

15.52 The AECB reports that, in Canada, there have been no accidents with reactors or radioactive materials causing detectable public harm and, other than in uranium mining, relatively few occasions of harm to workers and the environment.

15.53 The safety of Canada's 22 operating nuclear power reactors has also been addressed through independent studies. Twenty of these reactors are owned by Ontario Hydro, and one each by New Brunswick Power and Hydro–Quebec.

15.54 With respect to Ontario Hydro's nuclear reactors, the Ontario Ministry of Energy commissioned, in 1986, an independent study of reactor safety by experts in the nuclear power field. This study, the Ontario Nuclear Safety Review, and two subsequent updates examined the safety of Ontario's nuclear reactors

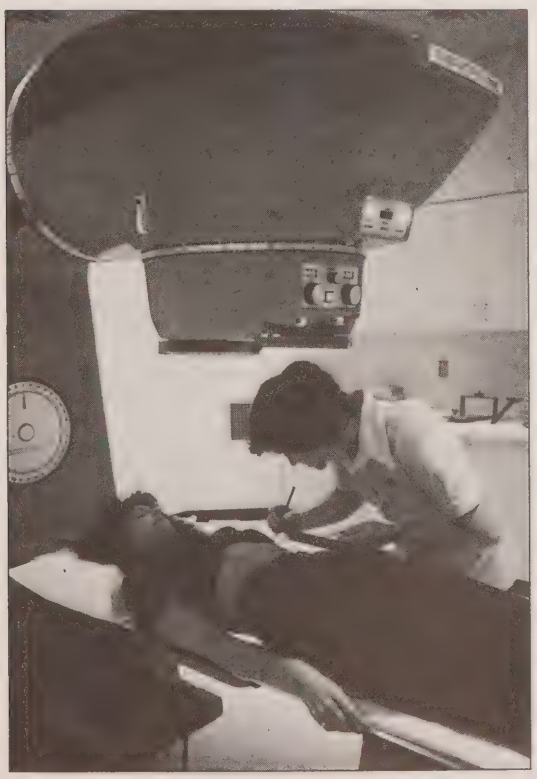
covering the period from 1987 to early 1993.

15.55 The original study found that these reactors were being operated safely, with no detectable harm to the Ontario public or Ontario Hydro's workforce. The reactors were also operating to high technical standards and without significant breaches of relevant AECB regulations. The later updates to this study found that the operation of Ontario Hydro's reactors, which now produce about 50 percent of Ontario's electrical power, continued to protect the work force and public safety. There were, however, some negative signs related to technical difficulties in operations over the last few years, which were being addressed by the utility.

15.56 There have been two independent reviews of the management systems of the nuclear power plant owned by New Brunswick Power Corporation. The Corporation states that these reviews, conducted by international organizations of nuclear experts, did not find any significant weaknesses at this plant. A similar independent international review is planned for the nuclear power plant owned by Hydro–Quebec in the fall of 1994.

15.57 In addition to technical competence of the regulator, the provision of assurance also requires effective management of the regulatory program. Our examination of AECB's management of its regulatory program identified

Nuclear energy has many uses including medical accelerators used in cancer treatment, smoke detectors and sterilization of surgical and medical products (see paragraph 15.49).







Source: AECB and Nordion International Inc.

several areas that require significant improvement.

AECB's Regulatory Framework Needs to be Strengthened

15.58 A regulator must have in place a regulatory strategy that defines various requirements, including: the degree of prescriptiveness desired; the available legal instruments; the basis for determining the extent and depth of the regulator's work; the manner and extent to which the regulator evaluates the competence of licensees and their staff; the regulator's scientific and engineering review and assessment policy; and its compliance inspection and enforcement policy.

The AECB is making or proposing major shifts in the way it operates and regulates.

Lack of a clearly documented regulatory strategy

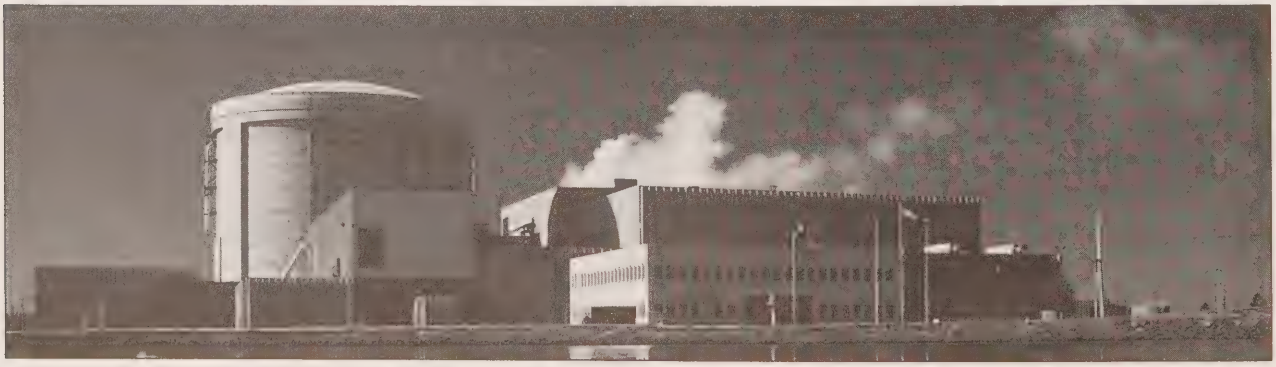
15.59 As described below, the AECB is making or proposing major shifts in the way it operates and regulates. These shifts are reflected in the recent promulgation of various internal policies and procedures, and in new or proposed revisions to AECB regulatory requirements as expressed in regulations, regulatory policies, guides and licence conditions. Two examples of these shifts are the AECB Compliance Enforcement Policy, first approved and issued in February 1993, and the recent AECB initiatives with respect to ensuring the competence of key nuclear power plant personnel.

15.60 In some areas, the AECB is moving toward becoming more prescriptive in its approach to the regulation of the nuclear industry. This means not only providing the "rules of the game" (telling the licensees what to do), but also providing more direction on how to do it. Factors influencing the degree of prescription stipulated by the AECB include the complexity of the activity, the experience with different technologies, and AECB's assessment of licensee competence. For certain activities, such as some uses of radioisotopes, the AECB is now documenting its safety requirements more explicitly than in the past.

15.61 A Ministerial Review Committee on the Staffing of the AECB reported in February 1990 that, with respect to reactor regulation, fewer staff than the increase requested would be needed if the AECB were to confine its activities to those of an auditor. Those activities would include

There are 22 nuclear power reactors licensed to operate in Canada, including the Point Lepreau nuclear generating station in New Brunswick (see paragraph 15.53).

Source: New Brunswick Power Corporation



ensuring that adequate processes are in place, conducting spot–checks to determine whether these processes are being properly applied, and reporting the results. The review also noted that certain AECB staff activities (planned or in progress) seemed to go beyond these functions. With respect to reactor regulation, the AECB has not clearly defined the nature of its audit role or the extent of inspection activities it wishes to undertake.

15.62 Another major shift is taking place in the way the AECB ensures that nuclear power plant personnel are well–trained and competent to undertake their duties. In the past, the AECB emphasized ensuring the competence of two key positions, shift supervisors and control room operators, who have primary responsibility for the day–to–day operation of the reactors. Candidates for these positions must pass a series of AECB–administered examinations, a process initially established in the 1960s, before they are authorized by the AECB to begin their duties. The AECB has not required requalification of these candidates.

15.63 In 1990, with the co-operation of the nuclear utilities, the AECB embarked on various initiatives to set up a new regulatory regime for examining the training and competence of operations personnel. Among the objectives, the initiatives are intended to:

- increase the relevance and efficiency of the regulatory process;
- include more plant personnel whose job function could affect plant or public safety;
- monitor training and competence initially and on an ongoing basis through periodic retraining and requalification; and
- facilitate improvement of utility training and AECB testing practices.

In addition, it is anticipated that the changes may result in increased reliance, where appropriate, on the utilities' training programs.

15.64 The regulatory strategy upon which these changes in approach are based has not been set out in a single strategic document.

Greater management discipline is required in updating regulatory requirements

15.65 One of the ways the AECB can meet its obligations as a regulator is by obtaining the views of its stakeholders on proposed regulatory requirements and by developing and promulgating the requirements in a timely manner.

15.66 Following preliminary communications with parties directly affected, proposals for new AECB regulations and significant amendments to existing regulations, as well as quasi–regulatory policies and guides, are usually distributed initially as consultative documents. This process, established in 1981 by the AECB, provides a mechanism for comment by licensees, the public and special interest groups. The period allotted for initial comments is normally three to six months, depending on the subject matter. The process therefore also serves as an early form of consultation as required by Treasury Board Regulatory Policy.

15.67 After completing the consultative process, a Regulatory Impact Analysis Statement is prepared for any proposals involving draft regulations. This Statement requires an analysis of the incremental benefits of the regulatory requirement in relation to the incremental costs. The draft regulations may also be

The AECB has not ensured the timely completion and implementation of many of the projects initiated to update its regulatory requirements.

amended to take into consideration the comments received. The regulations, along with the required Regulatory Impact Analysis Statement, are then submitted for approval through the federal regulatory process culminating in publication in Part II of the Canada Gazette. The AECB has identified some problems in the preparation of its Regulatory Impact Analysis Statements, particularly in analyzing and comparing the benefits of regulations against the costs.

15.68 The AECB has initiated projects to update its regulatory requirements and sought the views of its stakeholders; however, it has not ensured the timely completion and implementation of many of these projects.

15.69 As a case in point, the AECB initiated a "General Amendments" project in 1980 to amend its AEC Regulations, which had not been significantly amended since 1974. Of seven different sets of regulations, the AEC Regulations are the core set. The other six sets are more specific or more narrowly focussed. Although the General Amendments are intended to provide an updated, comprehensive basis for regulation of the nuclear industry, they are not intended to impose any significant changes to the scope of the regulatory regime. They were first issued for public comment in 1986, and substantive changes resulted from initial publication in the Canada Gazette in 1991. The General Amendments were expected to be republished in the Gazette in the third quarter of 1994, followed by formal approval shortly thereafter (14 years after this project was initiated).

AECB Comment: Due to certain legal issues in the amendments as drafted, the AECB has temporarily suspended further work on the General Amendments to the AEC Regulations until a decision on a proposed new Act to replace the existing Atomic Energy Control Act *is made. In the interim, the AECB has formed a task force to review its regulatory structure, redevelop existing regulations where a need clearly exists and develop new regulatory initiatives that would be compatible with the existing* AEC Act *and any new legislation. The delays encountered with the General Amendments also led to a comprehensive AECB Policy Statement (June 1994), as noted in paragraph 15.83, to better define and clarify its regulation–making process.*

15.70 Other projects include the introduction of new regulatory requirements related to calibration services for instruments measuring radioactivity, and to leak testing services. These two projects were initiated by AECB staff in 1985 and, after a period of public consultation, regulatory policies were drafted in late 1992. These policies have recently received senior management approval and are expected to be submitted to the Board for approval in the near future. Most prescribed substance and radioisotope licences require use of one or both of these services. At the time of the audit, the AECB did not have any formal standards in place for these services.

15.71 We noted that the AECB's consultative process has no established time frame for the ultimate disposition of a consultative document. For example, there are 21 documents listed in the AECB's 1994 Publication Catalogue that have not progressed beyond the consultative document stage, nor have they been withdrawn. Twelve of these documents are dated prior to 1990 and six are over 10 years old.

15.72 The Atomic Energy Control Board should seek ways to expedite the handling of documents through the consultative process and other stages so that they may be published in their final

form, such as regulations, policies or guides, or be withdrawn after a reasonable period of consultation.

AECB Response: Agreed. Procedures have been updated for the production of Consultative and Regulatory Documents that ensure early and frequent senior management involvement, appropriate authorizations at every stage, routine tracking and oversight of documents in progress, and adherence to a standard review period and sunset provisions. All "past due" Consultative Documents will be reviewed and either formalized, modified and reissued for comment, or withdrawn, by 31 March 1996.

Regulating through licence conditions poses problems

15.73 The AECB has subjected all significant amendments to its regulations to the federal regulatory process. However, the current regulatory framework does not contain specific regulations for nuclear waste management, decommissioning of reactors, and research reactors. The AECB sets out some of its regulatory requirements in these and other areas in licence conditions, which have the full force of the law.

15.74 The AECB also has quasi–regulatory instruments such as policies, guides and consultative documents, which have no legal force unless included in a licence condition. However, on a selective basis, the AECB may choose to impose these requirements by including them as licence conditions. Thus for those applying for new licences, it may be difficult to determine at the outset exactly what AECB's requirements are.

15.75 In addition to regulations, all other significant regulatory requirements included in licence conditions, with the exception of the licensee's own policies and procedures, are required to be subjected to the federal regulatory process. However, the imposition of these other significant regulatory requirements through licence conditions has bypassed this process. These latter requirements have not been subjected to a full Regulatory Impact Analysis Statement, to a competitiveness test of their impact on the nuclear industry, or to parliamentary scrutiny.

15.76 The Atomic Energy Control Board should reassess the extent to which it uses licence conditions to regulate the nuclear industry.

AECB Response: Agreed. The AECB is aware of the importance of respecting the licensing system and has a long–range strategy to move up the legislative chain as many regulatory requirements as possible. For instance, widely used licence conditions may become incorporated into regulation, and certain aspects of regulation, common to many areas of AECB activity, may eventually be incorporated in legislation. The AECB will consult its licensees on this matter in order to seek an appropriate balance.

Little progress made in documentation of regulatory requirements

15.77 In conjunction with an examination of its human resource requirements in 1989, the AECB reviewed its approach to regulation. This review identified a weakness in the documentation of AECB's regulatory requirements, particularly for nuclear reactor safety requirements and standards. One thrust of a 1989 Treasury Board decision to increase AECB's resources was to improve documentation of the AECB's safety requirements.

15.78 The Ministerial Review Committee on the Staffing of the AECB, completed in February 1990, also

recognized the need for improved documentation of AECB regulatory requirements. The Committee reported that there were many cases in reactor regulation where new requirements had been imposed on licensees without reference to the existing licensing regulations and guides. Recommendations included improved documentation of AECB requirements and improved recording and publication of decisions affecting licensing, including the reasons for the decisions pertaining to reactor regulation. However, there was to be no increase in prescriptive content.

15.79 Although AECB staff have undertaken some initiatives in this area, the required documentation is still not in place.

15.80 The Atomic Energy Control Board should document more fully its regulatory requirements, including the important precedents or regulatory positions that form the basis or rationale for them.

AECB Response: Agreed. The AECB will continue its multi–year effort to improve the documentation of its regulatory requirements. The process will involve consultation with stakeholders to ensure, among other things, the appropriate balance between general principles and prescriptive content.

The AECB has not yet developed up–to–date compliance and enforcement procedures and criteria for the areas we examined.

Lack of co-ordination of AECB's regulatory development process

15.81 The regulatory development process at the AECB is largely decentralized. It is the responsibility of each manager to initiate, as deemed necessary, new or proposed revisions to regulatory requirements. The manager then prepares the necessary consultative document, consults with stakeholders, and seeks the approval of AECB senior management and, where applicable, the Board. The Regulatory Affairs Unit within the Secretariat group ensures that the Treasury Board Regulatory Initiatives Process is followed.

15.82 Due in part to the lack of central co-ordination of AECB's regulatory development process, there are no detailed action plans for the development of regulatory requirements. Consequently, there are no priorities set for the regulatory initiatives to be pursued, no established dates for completion of these initiatives, and no management control or monitoring mechanisms.

15.83 In June 1994, AECB management approved and implemented an internal procedure to give the Regulatory Affairs Unit the responsibility to manage the overall process with respect to regulations, including the screening of new regulations and amendments to existing ones.

Opportunities to Improve the Implementation of the Compliance and Enforcement Function

15.84 It is vital for a regulator to have an effective compliance inspection and enforcement function. Included in Exhibit 15.2 is a listing of subject areas to be addressed by such a function.

Compliance and enforcement procedures and criteria are required

15.85 In February 1993, the Board approved an AECB Compliance Enforcement Policy. The objective of the policy is to establish a basis for AECB procedures and criteria to ensure that a comprehensive compliance program is in place. The policy is also intended to ensure that AECB compliance enforcement is uniformly applied in a vigorous, fair, predictable and timely manner. The enforcement procedures should provide for a graduated level of

enforcement tools to be applied, as appropriate, depending on the seriousness of the infraction and whether there have been repeated infractions.

15.86 The AECB has not yet developed up–to–date compliance and enforcement procedures and criteria for the areas examined. Such procedures and criteria are required by the Board policy to ensure fair treatment of all licensees. For nuclear power plants, the AECB has approved inspection procedures that are being updated, but it does not yet have in place enforcement procedures and criteria to support the new Board policy. The inspections manual for prescribed substances and radioisotopes is currently being updated, and enforcement procedures and criteria have been drafted but remain unapproved. No systematic compliance enforcement program or enforcement procedures and criteria exist for the AECB's responsibilities concerning transportation of nuclear

Compliance inspections, involving on–site and regional inspectors, ensure that licensees comply with the conditions of their licence and the Atomic Energy Control Regulations (see paragraphs 15.84 to 15.110).



Inspection of a nuclear gauge used for the measurement of ground densities in construction projects.



Inspection at a nuclear power plant.



Inspection of a radioactive source that is stored in an oil–well logging truck.

Source: AECB

materials. An outline for such a program was drafted in November 1993, but the detailed program requirements have not yet been developed.

15.87 The Atomic Energy Control Board should ensure that compliance and enforcement procedures and criteria are developed in a timely manner.

AECB Response: The AECB agrees that compliance and enforcement procedures and criteria should be developed in a timely manner and has already taken steps to address the situation. For example, an "Inspector's Rapid Reference Investigation/Litigation Guide" has been approved for radioisotope licences and draft criteria for a "Table of Inspection Grades" is close to approval. A new position has just been staffed and will be responsible for enhancing the AECB's compliance efforts in the area of nuclear materials transportation.

Full implementation of inspection requirements for nuclear power plants is necessary

The AECB has not applied its decommissioning policy consistently.

15.88 In addition to up–to–date procedures, important elements in the implementation of a compliance inspection and enforcement function are the identification of inspection requirements and priorities, and properly trained regulatory staff.

15.89 In December 1992, the AECB initiated a Task Analysis Project to define what the project officers at nuclear power plants should be doing and where the emphasis should be placed. As a result, the AECB identified more than 150 different types of tasks that could be undertaken by these project officers to determine compliance with the regulatory requirements. This project is also addressing the lack of written criteria for the level of review and frequency of inspection required to ensure an adequate level of safety in the nuclear power plants. The project will further set out priorities for the approved tasks.

15.90 We found that little formal, systematic training has been provided to these project officers. Without a clear definition of their role, requirements for training and experience of these project officers could not be explicitly specified. This issue is being addressed in the Task Analysis Project.

15.91 The AECB expects to begin implementation of the recommendations of the Task Analysis Project by September 1994. Given the importance of this project, we encourage the AECB to implement the recommendations as quickly as possible.

AECB Comment: Agreed. This project continues to proceed on schedule.

Inconsistent application of AECB's regulatory policy on decommissioning of nuclear facilities

15.92 In August 1988, the AECB published a regulatory policy on the decommissioning of nuclear facilities. The intent of the policy was that the licensees would be required to submit conceptual decommissioning plans for all their nuclear facilities. The policy stipulates that detailed decommissioning plans are required at least one year before the facility reaches the end of its operating life or within six months of an announcement of an unscheduled permanent shutdown. Between 1988 and early 1990, the AECB notified all its licensees of nuclear facilities of this policy. At that time, it requested copies of plans that would meet the requirements of this policy.

15.93 The AECB has not applied its decommissioning policy consistently. The AECB recently developed a data base showing that it has decommissioning

plans on file for 76 of the 164 licensed nuclear facilities. The strategy on how the AECB intends to obtain decommissioning plans for the remaining 88 facilities is under development. The requirement for decommissioning plans is not included in all licences for operating facilities.

15.94 Of the 164 nuclear facilities listed, 24 facilities are permanently shut down, some of which are partially decommissioned. The AECB has not received any decommissioning plans for nine of these facilities, where it was reasonable to do so.

15.95 Even where such plans do exist, there is little evidence that the AECB has reviewed them for compliance with its policy requirements and for reasonableness, including the related cost estimates. The AECB has not yet established clear criteria for the requirements to be included in these decommissioning plans. It plans to develop such criteria by March 1995.

15.96 The Atomic Energy Control Board should develop and consistently apply criteria for decommissioning plans for all nuclear facilities as quickly as possible.

AECB Response: *Agreed. The AECB is developing guidelines for the submission of decommissioning plans and will be applying these requirements consistently as soon as they are completed.*

Deficiencies in compliance and enforcement activities for prescribed substance and radioisotope licences

15.97 We identified several areas related to prescribed substance and radioisotope licences where AECB management processes and practices could be significantly strengthened. These areas include provision of guidance on what is meant by the various licence conditions and the relevant AEC Regulations; assessment of the competence of licence holders and, as appropriate, other licensee staff; and follow–up of inspection deficiencies.

15.98 Compliance criteria. For the approximately 3,700 prescribed substance and radioisotope licences, written guidance has not been provided by AECB headquarters to explain what is meant by the various licence conditions and the relevant AEC Regulations. This guidance and corresponding criteria are required to ensure that compliance inspectors apply a consistent inspection approach for each type of licensee. Without criteria, there is no basis for a common understanding of the regulatory requirements among the AECB unit that defines the regulatory requirements, the unit that verifies compliance, and the licensees.

15.99 Competence of licensees. The AECB must also be assured of the competence of licence holders and other licensee staff who are using or handling all types of prescribed substances and radioisotopes. This requires criteria to assess the adequacy of licensee training and to serve as a basis for compliance enforcement. The criteria should be available to the licensee as well as to AECB staff.

15.100 The AECB has done little to ensure that applicants for prescribed substance and radioisotope licences are knowledgeable about their obligations for complying with AECB regulatory requirements. Current AECB procedures do not adequately address the need for a licence holder to maintain this knowledge on an ongoing basis or to ensure that other licensee staff, as required, are similarly educated.

15.101 The majority of prescribed substance and radioisotope licences simply require that persons handling

radioactive materials be "properly trained". The AECB has established training criteria for some of the more hazardous uses of radioactive materials, such as radiography and irradiators, as well as hospital radiation safety officers. It has not, however, established criteria for determining what "properly trained" means for the large majority of licensee staff who handle prescribed substances and radioisotopes. In these latter cases, the licence condition cannot be properly enforced as there are no criteria against which to measure compliance. Consequently, the AECB cannot be assured that all those handling the prescribed substances and radioisotopes are adequately trained.

15.102 The nuclear utilities and some other major licensees have formal training programs and dedicated training personnel and facilities. However, it is unlikely that most licensees of prescribed substances and radioisotopes, which are small operations, would have such a capability. The smaller licensees are numerous and represent a wide variety of organizations. In our opinion, the AECB has a special obligation to these licensees to satisfy itself that management and radiation protection staff fully understand the regulatory requirements.

15.103 The Atomic Energy Control Board should satisfy itself that, for prescribed substances and radioisotopes, AECB and licensee staff have a common understanding of the regulations and licence conditions and the requirements for training.

AECB Response: *Agreed. The AECB is finalizing a document to explain the radioisotope licensing conditions, and training requirements are being developed beginning with the most hazardous uses. Explanatory material for the regulations has not been developed because the current regulations were to be replaced by the General Amendments. Because new regulations have been delayed pending a decision on a proposed new Act to replace the existing* Atomic Energy Control Act, *the need for explanatory material for the current regulations will be reviewed.*

15.104 Radiographers. A specific class of individuals handling prescribed substances and radioisotopes is industrial radiographers. The AECB has the authority to examine and certify radiographers as qualified operators under the AEC Regulations. AECB staff have proposed changes to the existing exam, which has not been updated since 1983. These changes have recently been approved by AECB management and are expected to be implemented by December 1994.

15.105 A lifetime qualified operator certificate is given to anyone who passes the AECB exam. However, the holders of these certificates are inspected only when the AECB inspects a licensee employing the qualified operator. As a result, some qualified operators may never be inspected in the field by the AECB for compliance with its regulatory requirements. Licensees employing qualified operators in the field of industrial radiography account for about 100 licensees or about 3 percent of AECB licensees. However, these licensees produce a disproportionate share of the incidents and overexposures (about 25 percent or 8 per year), and of the prosecutions (about 75 percent).

15.106 The Atomic Energy Control Board should reassess the use of lifetime certificates and inspection requirements for qualified operators in the field of industrial radiography.

AECB Response: *Agreed. The AECB is reviewing inspection procedures for industrial radiographers but it has no*

plans at this time to abandon the practice of issuing lifetime certificates for qualified operators. However, the AECB has drafted regulations to give it the power to revoke the certificate for serious violations. This initiative, when combined with inspections and monitoring of the radiation doses received by qualified operators, is believed to be sufficient.

15.107 Follow–up. There are opportunities to improve the effectiveness of AECB's follow–up on non–compliance issues related to prescribed substances and radioisotopes. After an inspection, the compliance inspector submits a report detailing items of non–compliance, if any, to the licensing division of the AECB. It is the responsibility of this division to ensure that corrective action is taken on those identified items of non–compliance.

15.108 Our review of licensing files indicated that the licensing officers accept a wide range of corrective action in response to reported items of non–compliance. In some cases, the licensee has submitted to the licensing officer a one–page response indicating that all noted deficiencies have been corrected, without any supporting documentation or explanation. In other cases, supporting evidence of corrective action for each deficiency was submitted with the licensee's response letter.

15.109 The lack of a formalized approach to follow–up may contribute to repeat items of non–compliance in subsequent inspections. We found a significant number of instances where inspections of licensees identified the same item of serious non–compliance in two consecutive inspections. The AECB is in the process of formalizing its procedures for follow–up.

15.110 The Atomic Energy Control Board should ensure effective follow–up of non–compliance issues related to prescribed substance and radioisotope licences.

AECB Response: Agreed. The AECB has increased the documentation requirements and review procedures when serious items of non–compliance are found.

Management of Interfaces with Other Jurisdictions

15.111 To reduce the regulatory burden on taxpayers and licensees, a regulator must ensure that it effectively manages the interfaces with other jurisdictions. This can be achieved through various methods of co-operation, such as harmonizing regulatory standards and processes; mutually recognizing standards, qualifications or technical specifications; delegating to other governments the responsibility for regulating or administering regulations; and sharing work and exchanging information.

15.112 Because some aspects of nuclear regulation relate to areas normally under provincial jurisdiction, or lie within areas of expertise of other federal departments or agencies, the AECB has developed a joint regulatory process with these other bodies. In this process, the AECB acts as the lead agency while the others contribute advice on their respective areas of jurisdiction or expertise. This process centres both on licensing and on ensuring compliance with the terms of the licence. It also attempts to avoid duplication and cross–purpose activities wherever possible.

More effort is required to reduce regulatory duplication, overlaps and gaps

15.113 Since 1981 the AECB has established a total of 12 agreements with other federal and provincial departments and agencies, which were intended to clarify roles and responsibilities in areas

The lack of a formalized approach to follow–up may contribute to repeat items of non–compliance in subsequent inspections.

of joint jurisdiction. These areas include the environment, transportation, occupational health and safety, pressure vessels in nuclear facilities, and uranium mines. Eight of these agreements are dated 1985 or earlier. At least two need updating to better reflect roles and responsibilities and changing circumstances.

15.114 The Minister's Advisory Panel on Regulatory Review reported in October 1993 that duplication of regulatory responsibility exists in matters affecting uranium mines. The AECB had been aware of this problem and has had in place for many years a memorandum of understanding with the Province of Ontario, under which the Province has carried out inspections of conventional health and safety requirements in the mines. In November 1993, the AECB signed a memorandum of understanding with the Saskatchewan government to reduce duplication and overlap in the regulation of Saskatchewan uranium mines. There is a need, however, to define the administrative arrangements for carrying out this agreement.

Additional co-operative agreements with federal and provincial jurisdictions need to be in place to accommodate AECB's responsibilities while "radioactives" are being transported.

15.115 Under the AEC Regulations, the AECB has responsibilities with respect to health, safety, security and the protection of the environment while "radioactives" are being transported. Transport Canada and some of the provinces also have certain responsibilities for the transportation of these materials. As many as 800,000 packages of radioactive material are exported, imported or shipped within Canada each year. These packages include radioisotopes used for industrial, agricultural, medical and research purposes, as well as material associated with nuclear power plants. The AECB does not have the legal authority to stop carrier traffic or shippers during the in–transit phase to carry out inspections. Thus co-operative agreements with the appropriate federal and provincial jurisdictions need to be in place to accommodate AECB's responsibilities while "radioactives" are being transported.

15.116 Under the federal *Transportation of Dangerous Goods Act*, Transport Canada sets standards for carriers for the transport of all dangerous goods, among which radioactive material is only one class. The AECB regulates packaging through its Transport Packaging of Radioactive Materials Regulations. In 1981, the AECB and Transport Canada entered into a memorandum of agreement on the transportation of radioactive materials. This agreement does not reflect the full extent of the AECB's responsibilities for radioactive materials in transit. In August 1991, a revised memorandum of agreement was drafted by the AECB, on the basis of its working experience, to clarify roles and responsibilities. This revised draft agreement has yet to be approved.

15.117 The provinces also have certain responsibilities for transportation matters within their provincial jurisdiction. Currently, there are no related co-operative agreements with the provinces. The AECB and the Ministry of Transportation of Ontario began consultations, in May 1989, to improve the enforcement of AECB regulatory requirements for the road transportation of radioactive materials in Ontario. At the time of the audit, no agreement had been finalized. The AECB will consider negotiating similar agreements with the other provinces, subject to experience with the anticipated Ontario agreement. In the absence of co-operative agreements with the provinces, the AECB is unable to fully meet its regulatory responsibilities

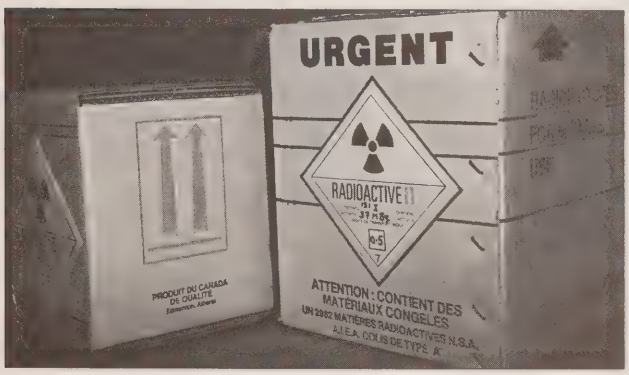
for the in–transit phase of the transportation of radioactive materials.

15.118 The Atomic Energy Control Board should review existing interagency agreements to ensure that they accurately reflect roles and responsibilities as well as current circumstances. It should define, as quickly as possible, the administrative arrangements for carrying out the agreement with the Saskatchewan government to reduce regulatory duplication in uranium mines, and with all provinces to provide for the enforcement of AECB's regulatory requirements relating to the transportation of radioactive materials.

AECB Response: *The AECB agrees that these items should receive appropriate priority. It is, for its part, expediting matters to the extent possible, while recognizing that the counterpart agency in each case may not attach the same priority to the situation.*

Many players are involved in dealing with nuclear waste

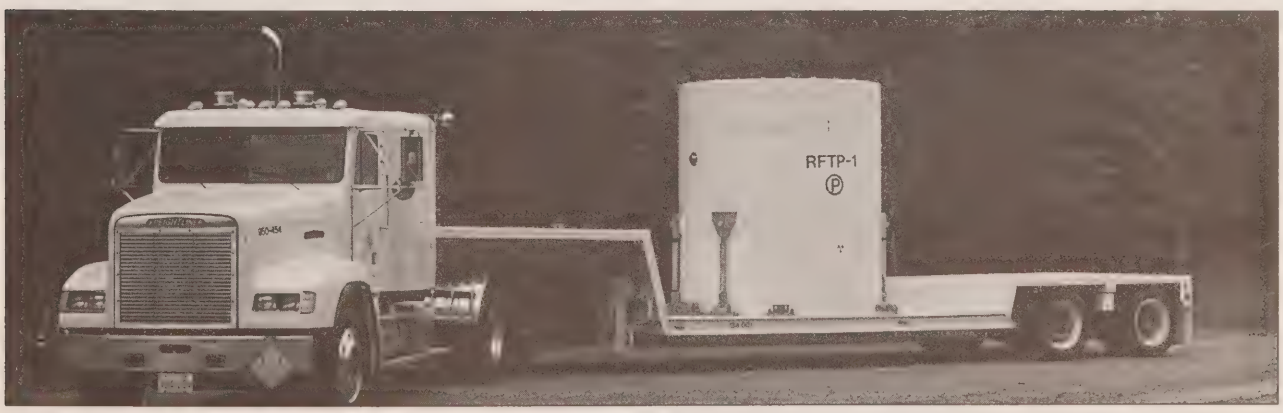
15.119 The AECB has a regulatory role in nuclear waste management. It is responsible for specifying regulatory requirements, judging solutions to nuclear waste management proposed in licence applications, issuing licences for waste storage and permanent disposal sites, and inspecting the licensed waste sites.



Packaged radioisotopes

The AECB sets the Canadian standards for transport packaging of all radioactive materials (see paragraphs 15.115 to 15.117).

Source: AECB



Ontario Hydro transport package

15.120 Responsibility for dealing with Canada's nuclear waste and resolving the problems related to low–level radioactive waste, used nuclear fuel and uranium mine tailings is fragmented among many players, including the AECB. The other players have been given some specific non–regulatory responsibilities associated with the management and eventual clean–up and disposal of nuclear waste.

15.121 We intend, in a future audit, to examine further the broader issue of federal management of nuclear waste, including the responsibilities of the other federal players, and the progress being made on outstanding issues.

Requirement for a Strategic Plan

15.122 In addition to having in place the key management systems identified in Exhibit 15.2, a regulator must also ensure that it manages its operations in an effective and efficient manner. Management must have a sound strategic plan that links programs and services to a regulatory strategy and provides a framework for resource determination.

The AECB lacks an adequate basis upon which to properly assess its human resource requirements.

15.123 The strategic plan needs to include the organization's purpose, objectives, goals and priorities. No such plan currently exists within the AECB that consolidates these various aspects of a strategic plan. The AECB initiated an action plan in January 1994 to develop a strategic plan, which is expected to be completed by June 1995. It is important that the AECB ensure, in developing its strategic plan, that it incorporates the substance of a clearly defined regulatory strategy.

The AECB has initiated development of a strategic plan.

15.124 The absence of a full–time President from January 1993 to September 1994 may have compounded the lack of strategic direction. It also resulted in the removal of a key link between Board members and AECB staff.

Roles and responsibilities are not clearly defined

15.125 Roles and responsibilities within the AECB are not clearly defined. The AECB is concerned that the current ambiguity in the division of responsibilities between head office and on–site or regional staff makes it difficult to establish individual accountability. Licensees have also expressed concern and confusion regarding the unco-ordinated demands originating from different areas within the AECB.

15.126 The AECB has started a project to improve the definition and documentation of the roles and responsibilities of each division and of individuals within their units. It expects to complete the first phase of this project by October 1994, for those regulatory activities related to nuclear power plants.

Human Resource Requirements Need to be Reviewed

15.127 To enable a regulator to properly assess human resource requirements, information must be available that typically is included in a regulatory strategy and a strategic plan.

15.128 In its Annual Report for 1988–89, the AECB stated that its resources were insufficient to enable it to assume its responsibilities fully. AECB management felt that staff, at that time, were unable to keep pace with the necessary processes of review, licensing, inspection and enforcement required by the level of regulation.

15.129 Following a series of internal AECB studies between November 1987 and May 1989, the AECB identified a need for a total of 246 additional

person–years to be obtained over a five-year period. This represented an increase of almost 95 percent above the 1989 authorized staff level. Our review of the related documentation disclosed that the AECB had not set out clearly the overall workload assumptions and rationale upon which it was basing these human resource requirements.

15.130 In 1989, a phased approach to the AECB's proposed expansion program was initiated. The first phases of this approach occurred between November 1989 and June 1992, with Treasury Board approving a total increase of 156 person–years. Staff increases were approved in recognition of the need for significant improvement in the effectiveness of nuclear regulation. However, due in part to the difficulties experienced in staffing specialized technical positions, AECB's actual strength as at December 1993 showed an increase of about 40 percent, or 110 person–years, above the 1989 level.

15.131 The resource increases approved to June 1992 were essentially consistent with one of the recommendations of the Ministerial Review Committee on the Staffing of the AECB. Because of the uncertainties in future development in the nuclear industry, the Committee felt it could not predict the AECB's resource requirements beyond this level. Therefore, it recommended that a detailed re-examination of the entire AECB staffing issue be undertaken in 1994. The government cutbacks announced since 1992 have heightened the need to re-examine AECB's resource requirements. Within the context of these cutbacks, the AECB completed, in April 1994, a report of staff allocation. Further review of the AECB's resource requirements is required.

15.132 The elements of AECB's regulatory strategy, strategic plan and workload assumptions have not been clearly defined, consolidated and approved. In the absence of such documentation, the AECB lacks an adequate basis upon which to properly assess its human resource requirements.

15.133 The Atomic Energy Control Board should:

- **clearly set out the workload assumptions and rationale upon which to assess its human resource requirements, consistent with a clearly defined regulatory strategy and strategic plan; and**

- **conduct a detailed re-examination of its entire staffing issue and determine whether it has sufficient resources to fulfil its mandate, and take steps to reconcile any differences.**

AECB Response: *The AECB agrees that it should better document its regulatory strategy, including the workload assumptions and rationale upon which its human resource requirements are assessed. The AECB intends to pursue further the efforts undertaken in 1994 on this subject.*

The Review Committee's recommendation for a re-examination in 1994 of the staffing issue was made in the expectation that the AECB might be requesting additional resources beyond 1994. In fact, the series of budget reductions imposed by the government since 1993 will prevent the AECB from achieving the staffing level authorized in 1992. The 1994 AECB review of its human resource situation was therefore done for a different reason from that which was originally foreseen. The AECB agrees that it must continue to assess its overall needs periodically, taking into account developments in the nuclear industry, in order to determine whether it has sufficient resources to fulfil its mandate.

The AECB has recently begun to take steps to address our concerns about program evaluation and internal audit.

The AECB Lacks Effective Management Oversight Mechanisms

15.134 Program evaluation and internal audit are important management oversight mechanisms that can help determine such things as:

- whether programs and activities are achieving intended objectives;
- whether the organization is operating in an economic and efficient manner; and
- where efforts should be concentrated to get the best value from the increasingly limited resources available.

15.135 The AECB has not conducted any formal program evaluation work since 1988. Important areas yet to be evaluated include regulation of nuclear power reactors, waste management, research facilities and accelerators; regulatory standards and requirements; and security of nuclear facilities and materials.

15.136 Some reviews of AECB's regulatory program have been carried out. For example, the AECB responded to the Ontario Nuclear Safety Review Study, which reviewed, in part, the AECB's regulation of power reactors. It also participated in the study by the Ministerial Review Committee on the Staffing of the AECB in 1989 and 1990, which examined, in part, the efficiency and effectiveness of all AECB regulatory programs. However, as reported in our 1993 audit of program evaluation in the federal government, such review mechanisms do not provide the same assurance on consistency of approach as program evaluations.

15.137 In addition, the AECB has completed only two internal audits since 1990. One audit was of the AECB's Office of Public Information and the other was of its cost–recovery program.

15.138 At the time of our audit, the position of the Audit and Evaluation Officer was vacant and the program evaluation and internal audit activities had been suspended. As a result, valuable management oversight mechanisms, which could have helped prevent or detect many problems identified by our audit, have not been effectively used.

15.139 During our audit, we brought to AECB senior management's attention a number of deficiencies in its proposed policy, plans and manuals for reactivating program evaluation and internal audit. The AECB has recently begun to take steps, including the appointment of an Audit and Evaluation Officer, to address our concerns about these important management oversight mechanisms.

Opportunities to Improve Reporting Mechanisms to Parliament and the Public

15.140 The AECB's Part III of the Estimates provides limited information on licensing actions and the number of compliance inspections associated with nuclear power plants and with prescribed substances and radioisotopes. Information to Parliament and the public could be improved, without adding to the existing Part III for the AECB, by providing a cross–reference to the AECB's Annual Report and to its Staff Annual Report on each nuclear power reactor site. Those reports provide more detailed information on these and other AECB activities.

15.141 However, our review of those reports revealed that they also could be improved by providing more meaningful information. The AECB Annual Report could, for example, include appropriate information on AECB's performance

indicators and comparisons to prior years to assess trends.

15.142 The AECB Staff Annual Reports on each individual power reactor site provide a potentially important source of information on the safety of these plants. However, we found that those reports are not consistent in the depth or the manner in which their purpose, details and conclusions are written. For instance, the performance information contained in the reports is presented without reference to specific quantified standards. It is also not refined to illustrate the significance of the information to the reader. In addition, multiple–year data are not always presented, where appropriate, to allow trend analysis.

Conclusion

15.143 To date, the AECB has provided Canadians with assurance that the nuclear industry is operating in a safe manner. In these changing and difficult times, even greater vigilance is required by the AECB, if it is to continue to provide this assurance. The 1946 *AEC Act* limits the AECB's ability to enforce compliance with its regulatory requirements and to meet new expectations with respect to health, safety and protection of the environment. It is important that changes to this Act be considered by Parliament.

15.144 In the areas we examined, we found that the AECB was not fully meeting its obligations as a regulatory body because of deficiencies in its management processes and practices. The AECB has already begun to take steps to improve its management processes and practices, but it is necessary that they complete the improvements in a timely fashion. It is expected that the new President, who took office in September 1994, will have an important role in setting the strategic direction that the AECB requires to improve its regulatory practices.

15.145 In our opinion, without updated legislation and improvements in its management processes and practices, the AECB will be hindered in its ability to provide assurance that the nuclear industry remains safe.

Without updated legislation and improvements in its management processes and practices, the AECB will be hindered in its ability to provide assurance that the nuclear industry remains safe.

Atomic Energy Control Board | Commission de contrôle de l'énergie atomique

President | Présidente

Ottawa, Canada
K1P 5S9

Votre référence Your file

Notre référence Our file
10-70-0

September 8, 1994

Mr. Denis Desautels
Auditor General of Canada
Office of the Auditor General of Canada
240 Sparks Street
Ottawa, Ontario
K1A 0G6

Dear Mr. Desautels:

As the newly appointed President of the Atomic Energy Control Board (AECB), I am pleased to receive your report. It has already been of value to the ongoing process of development, documentation and review of strategic planning required to enable the AECB to continue to effectively fulfil its mission, which is to ensure that the use of nuclear energy in Canada does not pose undue risk to health, safety, security and the environment.

Canada is among the world leaders in the peaceful use of nuclear energy. The AECB is dedicated to ensuring that its use by Canadians is safe. In order to establish a regulatory program which is as strong as possible in this regard, I have begun to address the issues you identified. Accordingly, the Atomic Energy Control Board would welcome continued interaction with the Office of the Auditor General.

While the AECB has primary jurisdiction for ensuring the safe use of nuclear energy in Canada, it has developed a cooperative regulatory process which involves other federal and provincial departments with expertise in such areas as health, environment, transport and labour. One of my goals is to review and strengthen the administrative arrangements which underpin this cooperative process in order to reduce overlap and duplication. Such partnerships would decrease the costs of carrying out our respective mandates and ensure that industry is not unduly burdened by regulation.

I welcome your observation that the 1946 *Atomic Energy Control Act* requires updating to reflect current circumstances. New legislation would provide the platform from which to reassess existing regulations and to launch the regulatory initiatives necessary to meet the challenges of today, which could hardly have been contemplated in 1946.

Canada

I will be working closely with my fellow Board Members, the Advisory Committees and the dedicated professional employees of the AECB to create an effective and efficient team to control and supervise the development, application and use of nuclear energy in Canada, and to facilitate active Canadian participation in international measures to prevent the proliferation of nuclear weapons.

Yours sincerely,

Dr. A.J. Bishop

94-181P&C/mmt

1994 Report of the Auditor General of Canada to the House of Commons

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The audit work reported in this volume was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

Chapter 16

Correctional Service of Canada

Custody of Inmates

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Correctional Service of Canada

Custody of Inmates

Assistant Auditor General: David Rattray
Responsible Auditor: David Brittain

Main Points

16.1 In 1992–93, Correctional Service of Canada (CSC) spent just under $1 billion to maintain 12,500 offenders who were incarcerated in federal prisons and to supervise another 9,500 offenders who were released conditionally into the community. The average direct cost to maintain an inmate in a CSC prison for the purposes of custody and rehabilitation was $48,000. When the costs of capital, the costs of national and regional headquarters, and the expenses incurred by other departments are included, this average may be as high as $80,000.

16.2 Even though Correctional Service is the agency responsible for administering federal prison sentences, it has limited control over its inmate population. Although solutions to many of the accommodation problems discussed in this chapter are the responsibility of Correctional Service, decisions made by the courts and the National Parole Board affect the number of inmates in CSC prisons.

16.3 Federal inmates are housed in prisons of different security levels (maximum, medium and minimum) according to the risk that they pose. A well–designed inmate security classification system is critical for minimizing the risk to public safety and reducing prison operating costs. We found deficiencies in the design and implementation of the Service's security classification processes. Correctional Service needs to have accurate and up–to–date information on inmates' classification and placement.

16.4 In both 1981 and 1986, we observed significant weaknesses in CSC's inmate accommodation planning. In this audit, we found that the Service has continued to favour retrofitting and replacement projects. The Service must spend some of its capital funds to maintain and retrofit deteriorating facilities to preserve capacity, but it has not performed the required life–cycle cost–benefit analyses to demonstrate the merits of this approach. It has also been slow to consider shared accommodation (cells built to accommodate more than one person) as an option. As a result, the Service was only able to increase its total capacity by 900 beds while the inmate population grew by more than 2,000 between 1986 and 1993. Consequently, double bunking (placing two inmates in a cell intended for one person) increased from seven percent in 1986 to 24 percent in 1993.

16.5 During the audit, the Service had to address the dichotomy of a growing inmate population and dwindling financial resources. As a result, Correctional Service plans to adopt a new double–bunking and shared – accommodation policy. We estimate that increased double bunking since the early 1980s has saved the taxpayer about $240 million in one–time future capital costs for building new prisons and has reduced operating expenses by about $60 million annually. If the Service implements its new policy of allocating up to 25 percent of its existing cell capacity for double bunking and shared accommodation, we estimate the Service would avoid a further one–time future capital cost in excess of $100 million and would save an additional $30 million annually in operating expenses. However, the Service needs to proceed with caution because this policy is a major departure from its traditional philosophy, and the long–term effects of double bunking and shared accommodation on the effectiveness of corrections are still unknown. The Service will also need to revise its long–range accommodation plan once this new policy is formally adopted.

Background

Corrections is a large and complex operation

16.6 The Correctional Service of Canada (CSC) was established when the former Canadian Penitentiary Service and the National Parole Service (then part of the National Parole Board) were merged in 1977. The Solicitor General is the Minister in charge of both the Correctional Service and the National Parole Board. Under his direction, the Commissioner of Corrections is responsible for the custody of inmates at federal prisons and the provision of correctional programs aimed at their satisfactory reintegration into society. As stated in Part III of its 1994–95 Estimates, CSC's mission is "to contribute, as part of the criminal justice system, to the protection of society by actively encouraging and assisting offenders to become law–abiding citizens, while exercising reasonable, safe, secure and humane control."

16.7 Under the provisions of the Criminal Code of Canada, persons sentenced to imprisonment of two years or more are held in federal penitentiaries. Young offenders and those receiving a sentence of less than two years are sent to provincial facilities. During 1993–94, Correctional Service had an average population of 12,500 inmates. (Of those inmates, only 250 were female offenders; the issues discussed in this chapter, unless specifically indicated, concern only male offenders.) In addition, the Service supervised about 9,500 offenders who were on day parole, full parole or statutory release.

16.8 In 1992–93, Correctional Service spent just under $1 billion and had a staff complement of about 10,000.

Exhibit 16.1 shows the breakdown of these expenditures by CSC's major functions: custody, rehabilitation and parole supervision.

16.9 Correctional Service spent a total of $620 million on the custody of inmates. That expenditure consisted of:

- $480 million to secure and accommodate the inmates in federal prisons;
- $120 million for equipment, construction and other capital investment; and
- $20 million for housing inmates in provincial prisons under exchange–of–service agreements.

16.10 Correctional Service also spent $215 million on rehabilitation programs and services, delivered inside federal prisons and designed to reintegrate offenders into society as law–abiding citizens. In addition, $125 million was spent on the supervision of offenders living in the community.

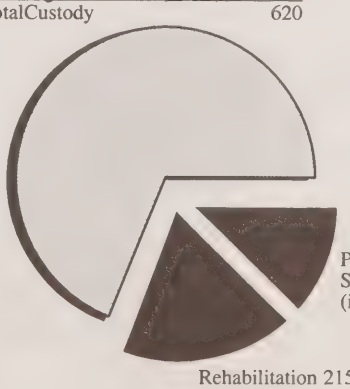
16.11 The average direct cost of maintaining an inmate in a federal prison in 1992–93 for the purposes of custody and rehabilitation was about $48,000 (as shown in the 1994–95 Expenditure Plan of

During 1993–94, Correctional Service had an average population of 12,500 inmates and supervised about 9,500 offenders who were on parole.

Exhibit 16.1

CSC's 1992–93 Expenditures
Millions of Dollars

Security and Accommodation	480
Equipment and Construction	120
Exchange of Service (ESAs)	20
TotalCustody	620



Source: Office of the Auditor General

The average direct cost of maintaining an inmate in a federal prison in 1992–93 was about $48,000 and could go as high as $80,000.

The average age of federal prisons is 41 years. Some institutions, such as the Dorchester and Kingston penitentiaries, are more than 100 years old.

the Correctional Service of Canada). If national and regional headquarters costs, expenses incurred by other federal departments and the cost of capital were included, we estimate the average cost could go as high as $80,000 (see Exhibit 16.2). Our estimate of the cost of capital is based on the assumption that it costs the government $150,000 to build an average prison cell, which has a useful life of 25 years, and that 100 percent of the capital is financed at an interest rate of 6.5 percent per annum.

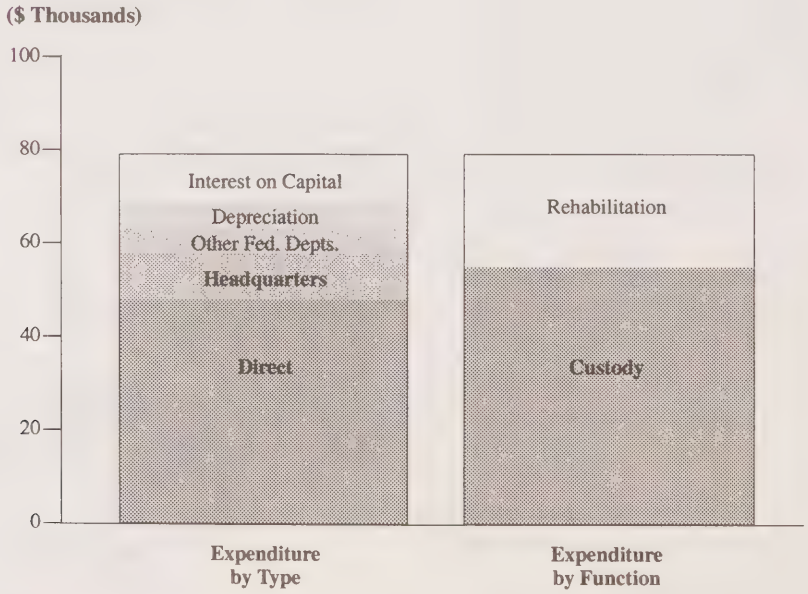
16.12 The national headquarters of Correctional Service is located in Ottawa. There are five regional headquarters, 43 penitentiaries and about 80 parole facilities (including area and district offices, and community corrections centres). The average age of federal prisons is 41 years. Some institutions, such as the Dorchester and Kingston penitentiaries, are more than 100 years old. The average number of beds in a federal prison is approximately 300. The largest prison, the Warkworth medium security prison in central Ontario, has 528 beds. The smallest prison, the Elbow Lake minimum security prison in the interior of B.C., has only 90 beds.

16.13 Financial restraint continues to place strong pressure on the federal public service to find ways to lower costs and improve efficiency in all aspects of its operations. Further reduction of funding is a strong possibility and, as a result, Correctional Service is aggressively working to streamline its administrative functions and to reorient the way it houses inmates.

16.14 During the last two years, Correctional Service has been challenged with the implementation of the *Corrections and Conditional Release Act*. This Act was proclaimed into force on 1 November 1992 and radically modernized the law applying to federal corrections. According to the new Act, "protection of society" is the paramount consideration in all decisions concerning the treatment and release of offenders. This approach affects accommodation requirements, since the minimum length of incarceration is increased for certain

Exhibit 16.2

Estimated Average Cost of Maintaining an Inmate in a Federal Prison



Source: Office of the Auditor General

inmates and reduced for others. CSC's approach to security classification of offenders is also affected by the new Act.

Keeping inmates in prisons of different security levels results in significant differences in cost

16.15 To perform its basic functions of custody of inmates, rehabilitation and parole supervision, Correctional Service must first provide accommodation for its inmates. Inmates need different kinds of accommodation depending on the risk they pose to the public, correctional staff, and each other. To meet these needs, the Service has classified its institutions into three security or custody levels — minimum, medium and maximum. In addition, there are three other specialized types of facilities. Special Handling Units are super–maximum security accommodation designed to handle the most difficult inmates. Regional Psychiatric Centres house inmates requiring treatment for mental or emotional disorders. Regional Reception Centres are where offenders spend 6 to 10 weeks for initial assessment after being sentenced by the courts. Both the psychiatric and reception centres provide multilevel security.

16.16 In 1981, our audit identified CSC's policy of "cascading" inmates. According to that policy, inmates are classified and moved to higher or lower levels of security, depending on the progress they make and the changing risks they represent, in order to achieve the best result at the lowest possible cost. As shown in Exhibit 16.3, the average annual cost per inmate for custody alone in 1992–93 was $56,000 for maximum, $36,000 for medium and $31,000 for minimum security. However, the costs per inmate vary significantly among prisons at the same security level.

16.17 The cost differential among security levels is due primarily to the higher operating costs for the greater staff complement needed to supervise and control inmates at each increase in security level, and to the higher capital costs for perimeter and building security requirements. Maximum and medium security prisons usually have double fences and perimeter intrusion detection systems (electronic security surveillance) as well as more expensive concrete block construction. Where they differ is in the degree of control exerted on inmate movement inside the prison. Inmate movement in maximum security prisons is

The cost differential among security levels is due primarily to the higher operating costs for the greater staff complement needed to supervise and control inmates at each increase in security level.

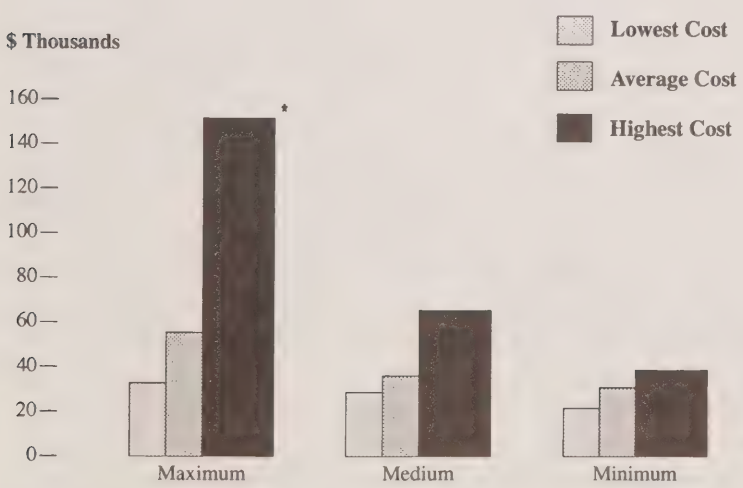


Exhibit 16.3

Annual Custody Cost per Inmate by Security Level, 1992–93

Includes direct and national and regional headquarters costs

* *These include specialized facilities such as regional psychiatric centres that are significantly more costly to operate than regular maximum security level prisons.*

Source: Office of the Auditor General

more stringently controlled than in medium prisons, with more staffed posts, thereby necessitating a higher staff–inmate ratio. Minimum security prisons do not use fences or other secured perimeter devices, and are usually of less expensive, more residential–type construction. They also have much smaller staff–inmate ratios, on average, as fewer barriers and staffed posts are in place.

16.18 Staff represent the largest portion of total correctional costs — about 60 percent. For funding and planning purposes, eight staff members are required for every 10 inmates at maximum security prisons, seven staff members per 10 inmates at medium security prisons, and five staff members per 10 inmates at minimum security prisons. In practice, we found that some prisons employ significantly more (or less) staff than the average for their custody level, for various reasons. Correctional Service has informed us, for example, that the architecture or structural layout and the size of a prison can affect the number of staff required to safely manage the inmate population. The Service is currently developing equitable resourcing formulae to examine the issues related to the large cost variances among prisons of the same level of security, as seen in Exhibit 16.3.

16.19 The relatively small average cost differential between the medium and minimum security prisons is due in part to the extent of double bunking in medium security prisons, which has reduced staffing costs significantly.

16.20 Exhibit 16.4 shows the layout of a medium security prison — the Bowden Institution. It has about 240,000 square feet of building space and a capacity of 415 cells. The space serves three principal functions: inmate housing; programs and employment; and services and administration. The cell size is small — 75 square feet — which is within the range of CSC's prison cell size of 50 to 90 square feet. However, inmates spend most of their waking hours outside their cells participating in various educational, employment and leisure activities.

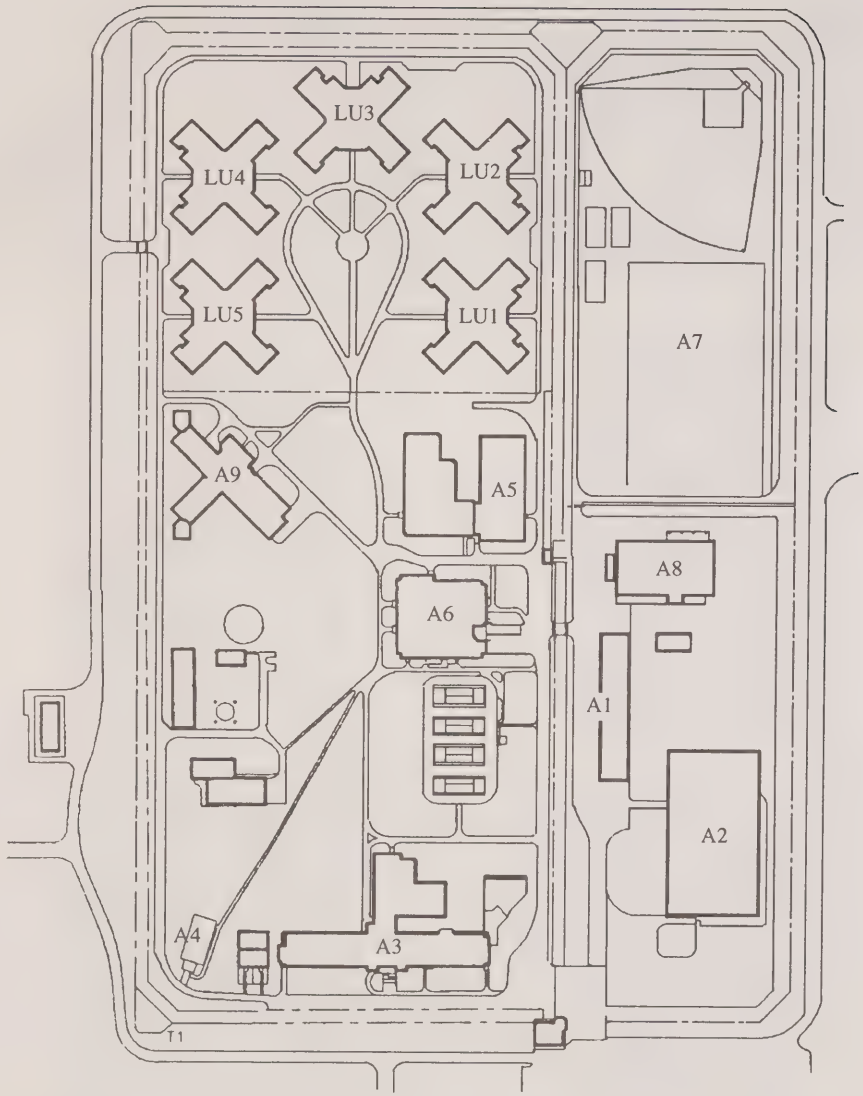
Audit Objectives and Scope

16.21 The purpose of our audit was to determine whether the Correctional Service of Canada has managed its largest activity (custody of inmates) with due regard to economy and efficiency. This involved a review of CSC's security classification system and its inmate accommodation program, both of which we audited in 1986. In the current audit of security classification, we sought to identify improvements needed that could affect both public safety and operating costs.

16.22 In the area of inmate accommodation, we attempted to determine whether CSC's accommodation policy and the planning process have improved since our audit in 1986. At that time, we observed that Correctional Service needed to document its accommodation policy, to improve its planning process and to reduce the imbalance between its bed capacity and inmate population at the medium and maximum security levels. We concluded that the Service did not conduct adequate life–cycle cost–benefit analyses in support of its proposed capital projects. (In a life–cycle cost–benefit analysis, different options are analyzed, comparing the total cost (construction and operating costs) and total benefit, financial and non–financial, of each option over its lifetime.) In addition, the 1986 audit concluded that Correctional Service failed to disclose

Exhibit 16.4

Layout of a Medium Security CSC Prison

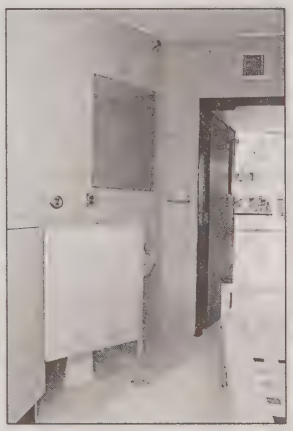
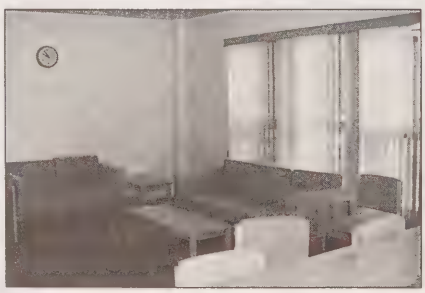
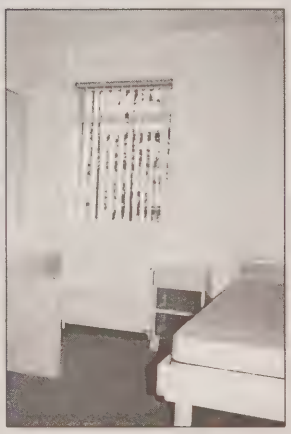


Bowden Institution Site Plan

A1	Maintenance Shop, Fire Hall
A2	Industries & Stores
LU–1	Living Unit – 1
LU–2	Living Unit – 2
LU–3	Living Unit – 3
LU–4	Living Unit – 4
LU–5	Living Unit – 5
A3	Administration
A4	Chapel
A5	Gymnasium/Library
A6	Kitchen/Dining
A7	Exercise Yard, Washroom, Sportsfield
A8	Vegetable Preparation Building
A9	Segregation Unit

Source: Correctional Service of Canada

Photographs of Three Medium Security Prisons

Exterior	Interior	Inmate's Cell
 *Traditional*		
 *Modern*		
 *Residential*		

properly all construction–related expenditures to Parliament.

16.23 The current audit also included a review of CSC's cost–reduction initiatives. The next two chapters report the findings of our audits of the National Parole Board and CSC's second major function, parole supervision. We plan to report on the third major function of the Service — rehabilitation programs — following an upcoming audit.

16.24 Our audit included interviews with Correctional Service staff and a review of documents at both national and regional headquarters. During our field work, we visited the five regions and many federal penitentiaries. We also visited the United States Bureau of Prisons and several state departments of corrections to identify potentially beneficial correctional practices. In reviewing CSC's security classification system, we co-ordinated our work with the Service's internal audit group and selected, at random, inmate files in the Ontario and Pacific regions for detailed examination.

Observations and Recommendations

Security Classification and Public Safety

Objective classification is necessary for effective correctional management

16.25 Security classification is a critical tool for correctional authorities in the management of both risk and cost. Inmates requiring similar levels of control and supervision are classified into groups for two reasons. First, not all inmates require the same security restrictions. Second, inmates tend to present fewer behavioral problems if they are confined with inmates similar to them in terms of aggressive tendencies and criminal inclination.

16.26 Security classification helps correctional management to minimize the number of assaults on both staff and inmates, and the number of escapes from prisons. It also helps management to plan and control the costs of correctional operations. To achieve these benefits, classification instruments need to be well designed. Ideally, they should be statistically derived so that they are able to assess objectively and quantitatively the risk posed by individual inmates. Such classification instruments would ensure consistency in decision making and allow for decisions to be more easily monitored. It is recognized, of course, that there must of necessity be some professional judgment involved when assessing risk. However, the benefits described above are difficult, if not impossible, to attain if the classification instrument uses only subjective, qualitative information.

Security classification is a critical tool for correctional authorities in the management of both risk and cost.

16.27 Once such an instrument is developed, it must be consistently implemented and carefully monitored to ensure appropriate application. Accurate and up–to–date classification and placement information can then be routinely produced and used to manage correctional risks and costs. Finally, instruments need to be revised periodically, based on actual experience, to ensure their continuing validity.

Better use of the Custody Rating Scale could enhance public safety

16.28 Since our last audit in 1986, Correctional Service has developed two new instruments for classifying its inmates — one for initial classification and another for subsequent reclassification. In 1987, it developed an objective classification instrument known as the Custody Rating Scale for initial

classification. This scale uses objective and verifiable data to measure the risk that an inmate poses with respect to public security and institutional adjustment. Actuarial studies were used to identify several factors that, when combined, indicate the security level appropriate to the overall risk posed by the inmate.

16.29 However, we have concerns about how the Scale was implemented. Because the Service is a decentralized organization and its national headquarters has never made it mandatory to use the Custody Rating Scale, only the Pacific and Quebec regions have used the scale for all initial classifications since its introduction in 1988. The Ontario, Prairie and Atlantic regions have only begun to use it in the past year. Two CSC research reports that assessed the implementation of the scale show that careful training, better information and tighter control are needed to ensure more reliable application. However, not all these issues were addressed when the scale was introduced in the latter regions.

16.30 Inmates are sometimes placed in a prison of a different security level from their classification. When that placement occurs for valid reasons, such as lack of rehabilitation program vacancies, proximity to inmates' family, or a psychologist's report, this is called an override. Other times, it may occur for invalid reasons, such as factors already accounted for in the classification instrument. Among correctional authorities, it is commonly agreed that when overrides exceed 15 to 20 percent, management must decide whether changes to the instrument are necessary or additional training is required.

16.31 Our review of about 100 inmate files revealed an unusually high level of overrides in the use of the Custody Rating Scale, at 19 percent and 36 percent respectively in the Pacific and Ontario regions. We also found that two out of every three overrides applied by case management officers in those regions were invalid. However, up until our audit, Correctional Service was not aware of these problems as it did not monitor the application of the Scale, including the use of overrides.

16.32 Proper security classification is important for public safety. CSC statistics indicate that, while an escape from a medium or maximum security prison is rare, the number of escapes from minimum security prisons has increased steadily from 112 in 1988–89 to 202 in 1993–94, as shown in Exhibit 16.5. In absolute terms, this is an increase of about 80 percent over a six–year period; however, on a basis of incidents per 1,000 inmates, the rate of escape fluctuates around 100, except for 1991–92 when it hit a high of 130. The Service has informed us that most of the escapees

Exhibit 16.5

Escapes from Minimum Security Institutions 1988-89 to 1993-94

** Data not maintained by the Service for these years.*

	88–89	89–90	90–91	91–92	92–93	93–94
Escapes	112	124	142	188	189	202
Inmate Population	1163	1201	1324	1450	1892	1959
Per 1,000	96	103	107	130	100	103
Number of Violent Reoffences while unlawfully at large	*	*	*	*	12	16

Source: Correctional Service of Canada

were recaptured shortly after escape. For example, 179 of 202 escapees in 1993–94 had been returned to federal prisons by the year end. It appears that escape problems are generally under control. However, we believe that Correctional Service could improve its classification practices to further reduce the risk to public safety.

16.33 From April 1992 to March 1994, 28 of the 390 escapees committed serious offences (robbery, sexual assault and attempted murder) while they were illegally at large. In May 1994, two inmates escaped from a minimum security prison in B.C., and were later implicated in a murder case in Oregon, U.S.A. An internal inquiry has concluded that inconsistencies in applying security reclassification may have been one of the major contributing factors in this case. A 1992 CSC study of escapes from minimum security prisons in Ontario, over a 15–month period in 1991–92, revealed that proper use of the Custody Rating Scale likely would have prevented 60 percent of those escapes because the scale would have classified and placed the inmates in medium security prisons. This clearly indicates that Correctional Service needs to review and improve its classification practices.

The reclassification process needs to be made more objective and quantitative

16.34 In 1990, Correctional Service developed a security reclassification process in anticipation that the new *Corrections and Conditional Release Act (1992)* would require that inmates, after initial classification, be reclassified once every 12 months until released from federal prisons. This process considers the risk that an inmate poses according to three factors: institutional adjustment risk, risk of escape, and risk to public safety if the inmate were to escape.

16.35 The new Act requires that inmates be placed in the least restrictive security level consistent with the protection of the public, staff and other inmates. The new Act also requires that other factors be considered in deciding where to place an inmate. These factors include the availability of treatment programs, proximity of the prison to the inmate's home, and the inmate's cultural and linguistic compatibility. As a result, it is not always possible to place inmates in prisons that precisely match their security classifications.

16.36 Using one instrument for initial classification and another for reclassification is a normal practice. However, we are concerned that Correctional Service uses an initial classification instrument (the Custody Rating Scale) that is quantitative and objective, but a reclassification process that is qualitative in nature and based almost totally on the individual judgment of case management officers. Furthermore, unlike the Custody Rating Scale, which is used only by an estimated 30 to 40 case management officers at the Regional Reception Centres, reclassification is performed by several hundred correctional staff working in CSC's 43 prisons. This extensive use increases the likelihood that problems will arise from the highly judgmental nature of this process.

A 1992 CSC study of escapes from minimum security prisons in Ontario revealed that proper use of the Custody Rating Scale likely would have prevented 60 percent of those escapes.

16.37 We found that, because of the highly qualitative nature of the reclassification process, inmates with similar risk factors have been reclassified and placed in prisons with different security levels. Our file review in Ontario revealed that over 300 downward transfers were refused by the receiving institutions on security grounds. Of these refusals, 125 cases (or 40 percent) were upheld by regional headquarters. Based on our

review of the experience in other jurisdictions, we believe this indicates that there may be a lack of confidence in the reclassification process as applied by the sending institution. If the process were made more objective and quantitative, the problem of confidence and accountability might be alleviated.

If the security classification process were made more objective and quantitative, the problem of confidence and accountability might be alleviated.

Information on inmate classification and placement is needed for cost management

16.38 Keeping inmates in prisons with higher security levels than necessary is not only more costly but also, according to Correctional Service, less desirable for rehabilitation. Correctional managers need accurate and up–to–date information on the number of overplacements and the reasons. This helps to make the necessary operational adjustments (for example, providing more program space or reducing security measures) to maintain control of capital costs and operating expenses.

16.39 We asked Correctional Service headquarters to provide us with this information as of 31 March 1994. However, we were informed that although this information is available in each prison, headquarters does not routinely gather these statistics and will not be able to do so until the computerized management information system becomes fully operational. In our opinion, the lack of this information in headquarters is a very serious problem.

16.40 The results of a survey that Correctional Service conducted for us in the summer of 1993, as shown in Exhibit 16.6, illustrate our concerns about the cost implication of overplacement. At that time, about 900 inmates were housed in prisons with a security level higher than their classification. Our review of security reclassifications for over 100 inmates indicated that there were many inmates residing in prisons with a security level greater than the classification that had been assigned to them. While some of these cases were due to factors prescribed in the new Act, a significant portion of the cases were due to inmates' refusal to be transferred.

16.41 Assuming that the number of overplacements (900) is accurate (though this is doubtful given the deficiencies in classification discussed above), and that perhaps half of the cases were due to valid reasons, then 450 inmates would have been overplaced invalidly. These overplacements appear to have a cost implication of about $6 million per year.

Exhibit 16.6

Placement of Inmates by Security Classification, Summer 1993

	Maximum Security Prisons	Medium Security Prisons	Minimum Security Prisons	Number of Inmates by Security Classification of Inmates
Maximum Security Inmates	1,347 *	155	0	1,502
Medium Security Inmates	474	6,575 *	188	7,237
Minimum Security Inmates	21	390	1,701 *	2,112
Number of Inmates by Security Level of Prisons	1,842	7,120	1,889	10,851 **

** Inmates housed in prisons with security levels equal to their own.*

*** An additional 1,600 inmates were housed in multilevel security prisons or waiting to be classified, for a total inmate population of about 12,500.*

Source: Correctional Service of Canada

However, with the extent of double bunking that exists in the federal prisons, the actual cost implication may be smaller.

16.42 Even if all classification problems were resolved, no major cost savings would occur overnight. This is because CSC's operations, like other correctional systems, are greatly influenced by the kind of prisons it has. Most of the operating costs are fixed in the short term and are difficult to adjust immediately. Improvements will come only if Correctional Service begins to use more accurate and up–to–date information in its long–range accommodation planning and to adjust accordingly the mix of its prisons by security level.

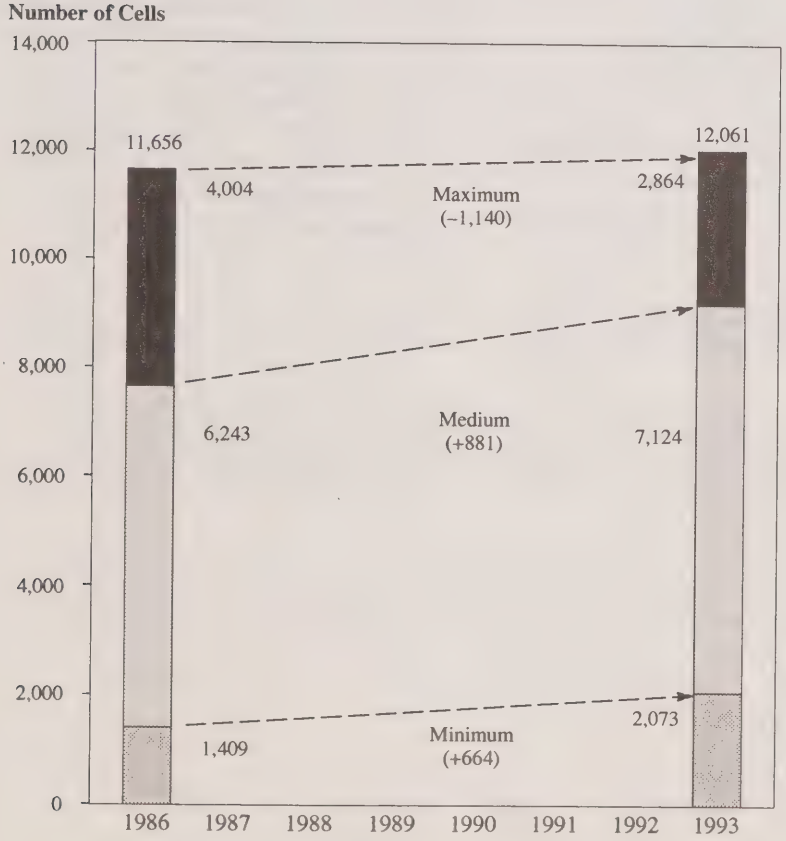
Reliable data are needed for effective accommodation planning

16.43 As shown in Exhibit 16.7, between 1986 and 1993, Correctional Service changed its bed capacity by security level significantly. Its maximum security capacity was reduced by 1,140 beds while medium and minimum security capacities were increased by 881 and 664 respectively. The trend reflects the philosophy of the *Corrections and Conditional Release Act (1992)*, which requires that inmates be placed in the least restrictive environment possible. However, the present prison mix by security level may not reflect the true security requirements, given all the deficiencies noted in CSC's classification system, for example, inadequately

The present prison mix by security level may not reflect the true security requirements, given the deficiencies in CSC's classification system.

Exhibit 16.7

Capacity Change by Security Level, from 1986 to 1993



Source: Correctional Service of Canada

designed instruments, lack of monitoring, and the absence of a reliable management information system at present. The fact that the rate of double bunking varies significantly among the three security levels (see Exhibit 16.8) indicates that more accurate data are needed for short–term inmate placement and long–range accommodation planning.

16.44 Two Correctional Service research reports, which assessed the implementation of the Custody Rating Scale and were mentioned earlier, place further doubt on the reliability of CSC's classification system. The reports concluded that the distribution of inmates by security levels resulting from the application of the scale differs significantly from both the actual placement of inmates and management targets (see Exhibit 16.9). The Service needs to reconcile this apparent difference as it could significantly affect the determination of CSC's bed capacity requirements by security level.

16.45 Correctional Service of Canada should overhaul the design and application of its security classification system by:

- **providing its staff with additional training on the Custody Rating Scale;**
- **ensuring that the Custody Rating Scale is applied to all initial classifications;**
- **redesigning the reclassification process to make it more objective and quantitative;**
- **monitoring, nationally, the quality of the security classification process, including better control over the use of overrides;**
- **producing accurate and up–to–date information on underplacement and overplacement for better management of costs and risk; and**
- **using this information in its long–range accommodation planning.**

CSC Response: The Offender Intake Assessment in its automated form in the Offender Management System is scheduled to be in place in November 1994. The Custody Rating Scale is part of the Offender Intake Assessment and will, therefore, be applied as one element of the comprehensive initial assessment. Training on the elements of the Offender Intake Assessment will be incorporated in the Risk Assessment Training, which will be provided to all case managers and decision makers between October 1994 and March 1995.

CSC's Research Branch has been tasked with the design of an instrument for

Exhibit 16.8

Distribution of Inmates by Security Level* 1993

* *Excluding inmates in the Reception Centres.*

	Minimum	Medium	Maximum	Total
Bed Capacity				
Number	2,061	6,792	1,900	10,753
% of Total	19	63	18	
Inmate Population				
Number	1,987	7,861	1,918	11,766
% of Total	17	67	16	
Double–Bunked Inmates				
Number	94	2,198	186	2,478
% of Population	5	28	10	

Source: Correctional Service of Canada

offender reclassification to replace the guidelines that are currently in use. The development of an objective and valid instrument normally takes a least one year. It is planned to have an instrument prepared for testing by September 1995.

With the Offender Intake Assessment, including the Custody Rating Scale, being integrated with the Offender Management System, it will be possible to create automated management information reports to monitor usage and overrides at the national, regional and local levels. This information can then be used by managers to improve the quality of the assessments for initial penitentiary placement and to forecast space requirements by security level.

The inmate security classification level is currently recorded in the Offender Management System, as is the level of the institution in which the offender resides. Automated management information reports will be developed to record, on an ongoing basis, the security classification profile of the inmate population and the differences between the individual classification levels and those of the institutions in which they are placed (underplacement and overplacement). This information can then be used as an element in the long–range accommodation planning for the Service.

It is important to recognize that the Service has not waited and is not waiting for these mid– and long–term solutions to address concerns about public safety. In the fall of 1993, the Commissioner required every case in minimum security to be reviewed. Regional Deputy Commissioners first reviewed all cases with a history of violence and caused to be transferred any case where the minimum classification was questionable. All cases in minimum security institutions have been reviewed and those not suitable transferred. This action was in direct response to the Service's commitment to public safety.

Classification instruments need to be revised to ensure continuing validity

16.46 There is general consensus among correctional experts that classification instruments need to be revalidated every five years based on the most current offender population. The Custody Rating Scale was developed using data related to the 1985 federal inmate population. Since then, there have been major legislative and demographic changes that may have affected the validity of the scale. For example, the *Corrections and Conditional Release Act (1992)* provides that first–time federal offenders convicted of non–violent crimes be processed for parole more quickly through an "accelerated parole review" process. Furthermore, the proportion of sex offenders in the federal prisons has increased dramatically in recent years. Clearly, there is a need for Correctional Service to review the continuing validity of the scale.

Major legislative and demographic changes may have affected the validity of the Custody Rating Scale.

16.47 We will use the "accelerated parole review" process in the new Act to illustrate the importance of updating

	Minimum	Medium	Maximum
Management Target	15.0%	73.0%	12.0%
Custody Rating Scale	32.3%	61.0%	6.7%
Actual Placement	8.4%	78.9%	12.7%

Exhibit 16.9

Placement of Inmates by Security Level – Implementation of Custody Rating Scale in the Quebec and Pacific Regions

15 August 1988 to 15 January 1989

Source: Correctional Service of Canada

classification instruments. One might assume that Correctional Service would place most of those inmates recommended for accelerated release in its minimum security prisons. However, of the 938 inmates released under this provision between 1 December 1992 and 31 March 1994, 40 percent came from medium security prisons. This indicates an apparent inconsistency — although the Custody Rating Scale does not rate those inmates to be a low enough risk for minimum security custody, the Act considers them a low enough risk for release on accelerated parole. We are not suggesting that Correctional Service place all such candidates immediately into minimum security prisons, but we think the Service needs to re-evaluate the scale.

16.48 Many other jurisdictions reclassify their inmates twice a year to increase the degree of cascading and thereby reduce their operating costs. Correctional Service could also benefit if it improved the timeliness of its security reclassification. Exhibit 16.10 shows that more than half of federal parolees are released from medium and maximum security prisons — the norm since 1986. We believe that if Correctional Service were to reclassify its inmates more frequently than once a year, for the purpose of cascading to the next lower level of security, it could realize considerable savings.

16.49 Correctional Service of Canada should:

- **revise the Custody Rating Scale as soon as possible, using the most current data, to ensure its continuing validity;**
- **consider including additional factors in the scale to ensure more consistency between the inmate security classification system and the provision for accelerated parole review; and**
- **consider reclassifying inmates more frequently than on an annual basis and place more emphasis on the consistency between security reclassification and other risk assessment decisions such as transfer and parole.**

CSC Response: *As noted in the report, the Custody Rating Scale has not yet been consistently applied across the country. It has been used on a pilot basis. It was always intended that its use would be mandatory only after the implementation of the Offender Intake Assessment process in November 1994. A data base of adequate size on the use of the Custody Rating Scale and its indicators will then exist and enable decisions to be made as to which alterations to the scale should be made. The Research Branch has been requested to undertake this study as soon as is feasible.*

The question of consistency or correlation between Accelerated Parole Review status and individual inmates' security classifications will be examined. The characteristics of those who escape from

Exhibit 16.10

Number of Paroles by Security Level of the Releasing Prison, 1993

Security Level of the Releasing Prison	Day Parole	Full parole	Total	Percent
Maximum	328	161	489	8%
Medium	2,172	782	2,954	46%
Minimum	2,072	882	2,954	46%
Total	*4,572*	*1,825*	*6,397*	*100%*

Source: Correctional Service of Canada

minimum security facilities and of the Accelerated Parole Review group (mainly property offenders) show some overlapping factors, such as a high probability of recidivism. However, a more complete examination of the question will be conducted.

The minimum requirement for the review of an inmate's security level is once per year. However, in preparation for any critical decision relating to the inmate (transfer, temporary absence, conditional release), the policy calls for the individual's security classification to be reviewed and confirmed or amended. The results of that review are communicated to the person making the decision. Therefore, many inmates are being reclassified more frequently than on an annual basis and this information is being linked to other risk assessment decisions. The Risk Assessment Training being delivered to several thousand staff, including all case managers and decision makers, prior to the end of fiscal year 1994–95, will assist all parties to use the information more effectively.

Inmate Accommodation

Correctional Service has limited control over the size of its inmate population

16.50 Even though Correctional Service is the agency responsible for administering prison sentences, it has virtually no control over the number of admissions or discharges from its prison system. The courts decide the number of offenders entering CSC's facilities and the lengths of their sentences. Both these factors affect CSC's inmate population. The National Parole Board (NPB) controls the number and the timing of inmates discharged from federal prisons on conditional release. Correctional Service can influence the size of the inmate population only by preparing inmates for the earliest possible release and by providing the best possible supervision to help prevent those released conditionally from returning to custody. In fact, this effort has been CSC's primary corporate objective since 1990. However, over the years, the National Parole Board's rate of

Between 1986 and 1993, although CSC's inmate population grew from 10,500 to 13,200, its own cell capacity increased only from 11,656 to 12,061.

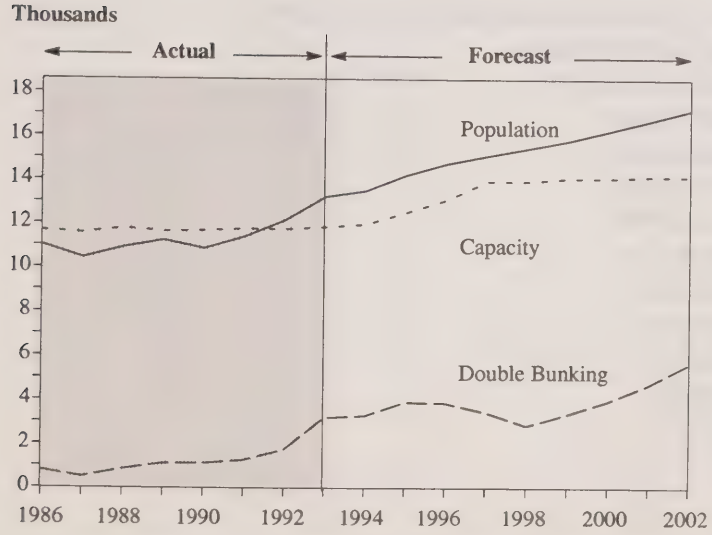


Exhibit 16.11

Inmate Population, Capacity and Double Bunking

Source: Correctional Service of Canada

granting parole has fluctuated and affected CSC's ability to achieve its objective. It is very difficult for the Service to project accurately the future inmate population.

16.51 To manage inmate accommodation effectively, Correctional Service must maintain an appropriate balance between demand (number of inmates) and supply (number of beds). It must use its capital funds judiciously to supply the greatest number of beds for the funds available to meet the demand of an increasing number of inmates. Exhibit 16.11 shows that, between 1986 and 1993, although CSC's inmate population grew from 10,500 to 13,200, its own cell capacity increased only from 11,656 to 12,061.

16.52 In our 1986 audit, we observed that Correctional Service had been double bunking its inmates "to overcome temporary shortages of accommodation" (seven percent of the total inmate population were double bunked). According to CSC's statistics, the rate of double bunking increased to 14 percent in 1992 and 24 percent in 1993. It is important to note that although the total inmate population was below the total bed capacity until 1992, double bunking still occurred. This was because the distribution of prison beds by region and by security level did not match the location and security needs of inmates.

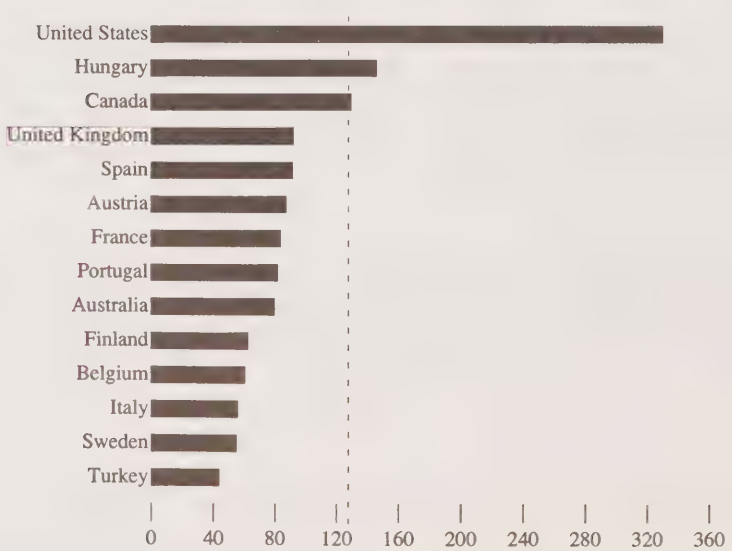
16.53 The 1994–95 long–range accommodation plan of Correctional Service shows that the rate of double bunking will increase even further, to more than 30 percent in the year 2002 (see Exhibit 16.11). These forecasts, however, will change when Correctional Service revises its long–range plan to reflect its new proposed policy concerning double bunking and shared accommodation.

16.54 Canada is not the only nation that has experienced the problem of prison overcrowding. According to "Basic Facts About Corrections in Canada", 1993 Edition, in 1992 Canada had an incarceration rate of 130 (the number of adults and juveniles in either federal or provincial prisons per 100,000 population). This compares with 330 in the United States and 92 in the United Kingdom (see Exhibit 16.12 for further details). Canada and the United States are two countries that have experienced more serious prison overcrowding problems.

Exhibit 16.12

Comparison of Imprisonment Rates

Rates expressed per 100,000 Total Population (Adults & Juveniles)



Source: Basic Facts About Corrections in Canada, 1993 Edition

16.55 The high rate of incarceration in the United States is due, in part, to its "get tough on crime" and "war on drugs" policies. In many parts of the U.S., double bunking is the norm rather than the exception. In many states, in order to alleviate severe overcrowding problems in the prisons, the courts have ordered prison authorities to let some "old" inmates go prior to normal release date so "new" inmates can be admitted.

Correctional Service did not carry out life–cycle cost–benefit analyses to support its accommodation decisions

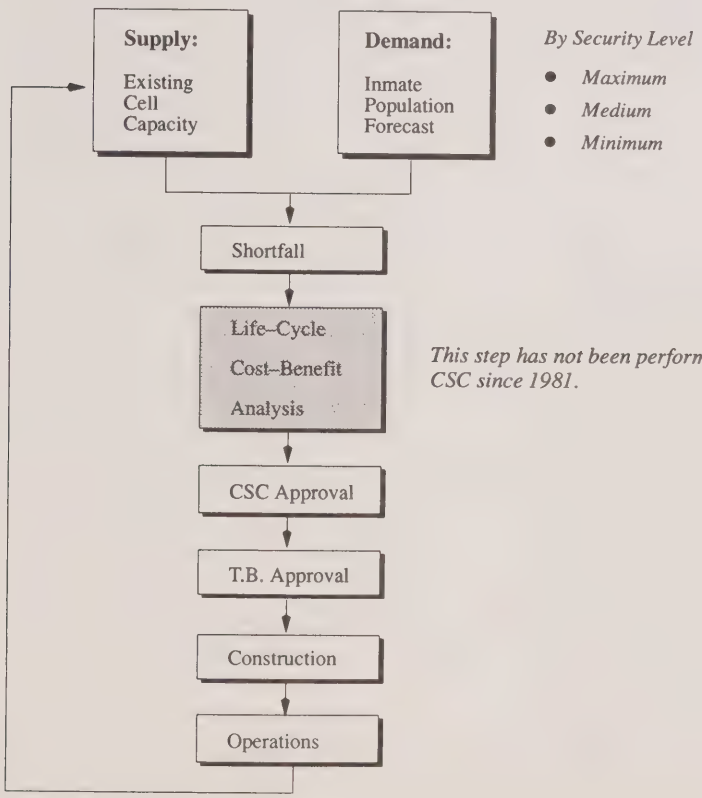
16.56 Correctional Service has developed a simple process for planning inmate accommodation using a supply–demand model. Exhibit 16.13 illustrates its annual accommodation planning process. This process compares demand (number of inmates in planning years) with supply (number of beds available) in order to determine where shortfalls are most likely to occur, by both region and security level. After completing this process, regional headquarters develops strategies to address the shortfall of bed capacity. The options considered by the regions include:

- adding capacity by enlarging an existing prison;
- adding capacity by building a new prison; or
- purchasing capacity through exchange–of–service agreements (ESAs).

16.57 ESAs are federal–provincial agreements by which the federal government purchases bed space in provincial prisons for use by its inmates. In addition, Correctional Service has changed the designs of its prisons and construction specifications to maximize

Exhibit 16.13

Steps in CSC's Accommodation Planning Process



Source: Office of the Auditor General

the efficient use of its capital resources. As a theoretical framework, CSC's accommodation planning process is logical.

16.58 Within a period of eight years, from 1986–87 to 1993–94, Correctional Service spent a total of $807 million in capital funds for various purposes:

Within a period of eight years, from 1986–87 to 1993–94, Correctional Service spent a total of $807 million in capital funds.

- $58 million was spent on completing two new prisons (Atlantic and Port Cartier) for which construction started prior to 1986–87;
- $200 million was directed to major projects to preserve assets and to projects that replace or expand cell capacity in the existing prisons;
- $323 million went to minor construction and maintenance projects that did not materially affect cell capacity. Most of these projects were delegated to the regions and they included installing improved security systems, constructing and modifying facilities to meet administrative, program and operational requirements in existing prisons, as well as retrofitting common service facilities outside prisons;
- $180 million was used for equipment purchases; and
- $46 million was for capital contributions to the provinces for additional cell capacity under various exchange–of–service arrangements.

We are concerned that CSC documents do not clearly indicate what is and what is not included in the scope of these capital projects.

16.59 As a result of these expenditures, the Service had, between 1986–87 and 1993–94, refurbished or replaced about 1,400 cells, added 1,300 new cells (500 in the two new prisons and 800 through capacity expansions) and secured another 500 beds through exchanges of service with the provinces. But when the 900 beds that were withdrawn because of closures of prisons, such as Laval penitentiary, are taken into account, the Service only achieved a net increase of 900 beds in its rated capacity during an eight–year period when the inmate population grew by more than 2,000.

16.60 Maintaining and retrofitting older facilities preserves existing capacity. CSC's capital infrastructure has deteriorated over time and has periodically required urgent attention. This may explain, in part, the tendency to retrofit. Although Correctional Service conducted condition surveys and prepared master development plans for its prisons, it did not produce life–cycle cost–benefit analyses to support its decisions despite a requirement to do so by both its own and Treasury Board's policies. This weakness was commented on in both the 1981 and 1986 Reports of the Auditor General.

16.61 One explanation for CSC's retrofit policy is that building new prisons can become politicized as part of regional socio–economic development considerations and can involve lengthy approval processes. The "lead time" required in constructing a new prison is often more than seven years. Therefore, retrofitting has become a common practice for Correctional Service to avoid that lengthy and uncertain process. The retrofit projects at the Kingston Penitentiary and the Dorchester Penitentiary are examples of this practice (see Exhibit 16.14 — Case Study 1–1).

16.62 We also found that in the Kingston retrofit the region had channelled a significant amount of the funds under its control to supplement the completion of the retrofit. Although the scope of both headquarters and regional retrofit work was defined in the Treasury Board submission, only the cost for the former was provided. Inclusion of the total cost would have provided the Treasury Board and Parliament with more complete information for decision making. Details of this practice are also

Exhibit 16.14

Case Study 1: The Need for Life–Cycle Cost–Benefit Analysis

1 – 1. Retrofit of the Dorchester Institution

In 1981, Correctional Service launched a detailed cost–benefit comparison of two options for the Dorchester Institution in New Brunswick: constructing a new institution on the same site or redeveloping the existing facilities. CSC documents indicate that during the preparation of the report, a ministerial direction "to maintain the status quo" was received. As a result, two additional options were included in the study: maintaining the status quo at either the current capacity or at a reduced capacity.

The study concluded, "As a result of comparable life–cycle costs, significantly superior qualitative response to requirements and minimal associated risk, it is recommended that Dorchester Institution be replaced with a new institution." The study argued that a redeveloped institution would require 302 person–years to operate while a brand–new facility would require only 260 person–years. The 42 person–year differential amounted to $915,600 per annum, or $23 million over a period of 25 years, while an additional incremental capital expenditure of $6 million would be required to build a new facility. The study also concluded that the maintenance of the status quo would not address existing operational deficiencies. In addition, it pointed out that keeping things "as is" would cost a premium of $1 million per year to support the ongoing capital construction program, over and above the costs associated with a new institution. However, as internal documents indicate, Correctional Service was subsequently directed to maintain the status quo (no retrofit and no new institution).

To maintain the status quo for the next seven years, from 1983 to 1990, the Service spent $20 million on various capital projects such as upgrading fire and safety systems and reroofing the buildings. About $9 million of this amount was required for the regular ongoing minor capital program. In December 1991, the Service received Treasury Board approval to proceed with the retrofit of Dorchester at a total estimated cost of $19 million. The retrofit involved 222 cells and altered the function of some of them from general purpose to psychiatric treatment and special needs. Correctional Service did not conduct a new life–cycle cost–benefit analysis in 1991 to support its decision to retrofit Dorchester.

Phase one of the retrofit was completed in 1994, at a total cost of $19 million. The Service is proposing to proceed with phase two of this project, which would retrofit another 200 cells, at an additional cost of $8 million. This means that by the time the retrofit is completed, the total cost will be about $47 million or over $114,000 per bed.

The 1981 study concluded that the operating cost of the retrofitted Dorchester would be higher than that of a new prison. Today, the custody cost per inmate at Dorchester, at $66,000 per year, is the highest among CSC's medium security prisons. This cost figure substantiates the 1981 departmental cost–benefit study that forewarned Correctional Service of the higher operating costs associated with the retrofit option.

1 – 2. Retrofit of the Kingston Penitentiary

Kingston Penitentiary has been in operation since 1835. Many of its site services and buildings have deteriorated to the point where breakdowns are frequent, maintenance is costly and a total system failure could occur. Many old buildings and systems do not meet today's fire and safety standards, and the existing program space is insufficient and substandard.

In June 1990, the Treasury Board approved CSC's submission to retrofit the Kingston penitentiary at a total estimated cost of $43 million. The submission stated that the cost of retrofitting would be less than one half the cost of building a brand–new facility, which was estimated to be between $80 and $100 million. However, as was the case with Dorchester Penitentiary, Correctional Service did not conduct a life–cycle cost–benefit analysis to compare all feasible options, such as constructing a new single or shared accommodation multilevel institution with the same or an increased capacity. The proposed scope of work includes the complete retrofit of the institution's sewage, electrical, mechanical and fire safety systems; extensive modifications to the hospital; renovations and additions to the psychiatric treatment capacity; and the reconstruction of the interior of an old building to provide additional, modern program space.

A review of CSC's files indicates that the cost to complete the Kingston retrofit by 1996–97 will be $58 million, not $43 million as shown in the submission to the Treasury Board. The Ontario region has spent $15 million from its own regional capital budget for such projects as the upgrading of the institution's stone walls and the replacement of its outdated windows and roofs. In addition, we note that before Treasury Board approval in 1990, Correctional Service had already spent approximately another $16 million since 1983 on various capital projects at this site. About half of this amount was required for the regular ongoing minor capital program. Thus, the total cost of retrofitting the Kingston Penitentiary amounts to $66 million. However, the Treasury Board has never been informed of this total cost.

Correctional Service has informed us that a cost–benefit analysis was done in 1982, which concluded that the low annual operating cost of the institution made the retrofit option more economical than constructing a new prison. However, CSC's 1990 submission to the Treasury Board did not refer to this study and the Service has not been able to provide us with a copy of this analysis.

provided in Exhibit 16.14 — Case Study 1–2. We are concerned that CSC documents do not clearly indicate what is and what is not included in the scope of these capital projects. We believe that if regional funds are to be used in a retrofit project, they need to be clearly identified and included in the life–cycle cost–benefit analysis of options.

16.63 At a number of locations, such as Millhaven in Ontario and Drummondville in Quebec, CSC's original plan was to build more than one prison (of different security levels) to achieve economies of scale and lower operating costs by sharing common services, such as water, sewage and electrical systems. However, political decisions have reduced CSC's ability to realize savings by co–locating new institutions at these sites (see Exhibit 16.15 — Case Study 2).

16.64 The only documented life–cycle cost–benefit analysis produced by Correctional Service was in 1981. It indicated that retrofitting an old facility would be more expensive than constructing a new facility at the existing location. Ten years later, the retrofit approach is likely to be an even more expensive option, because of further deterioration of the facility and the introduction of government regulatory requirements including handicapped accessibility, fire protection and air quality standards.

16.65 Studies by other jurisdictions, including the U. S. National Institute of Corrections, indicate that retrofitting a

Exhibit 16.15

Case Study 2. Inability of Correctional Service to Optimize the Co–Location Option

2 – 1. Port Cartier and the Drummondville Site

In March 1983, Correctional Service proposed the construction of a protective custody institution, at a capacity of 249 beds, to be built adjacent to the existing medium security institution in Drummondville, Quebec. This proposal would allow the Service to take advantage of the infrastructure (water, sewage, etc.) that had already been installed at that site and to realize an economy of scale for common services and administration. However, the decision was made in 1985 to build the proposed protective custody institution at Port Cartier, at the same capacity, instead of at Drummondville. The building of the institution at Port Cartier was not based on need but on non–program considerations, such as providing economic benefits to a depressed area. As reported in our 1986 Report, the impact of this decision was that it increased the one–time construction cost by $11 million and the annual operating costs by $3 million.

2 – 2. The New Medium Security Institution for Ontario and the Millhaven Site

In 1991, Correctional Service proposed the construction of a new 400–bed, low–medium security institution, at a cost of $60 million, based on a projected inmate population increase. The new institution was to be located at the same site as the Millhaven and Bath Institutions. The site is already fully serviced. This location would allow the new institution to take advantage of existing common services, including water, sewage and electrical systems. An internal study indicated that building the new medium security institution at this location would save $10 million in development and construction costs and $2 million annually in operational costs.

However, in August 1992, after alternative sites outside the Millhaven area were evaluated, the Minister directed that the new institution be built next to the Beaver Creek Institution in central Ontario. This proposal represented a $7 million increase in the budget to cover the costs of constructing water, sewage and electricity facilities that, unlike the Millhaven site, are not available at the site. Although the Treasury Board approved the new proposal, it has not provided the additional funding. Correctional Service will have to find this extra $7 million through internal reallocation of its capital funds.

large facility is usually a more expensive option than building a new prison. The decision to renovate or to build a new facility requires comparison of the conditions, problems and resources that are unique to each project. Each comparative analysis should consider not only the costs (both the initial capital costs and the operating costs) but also the benefits (both financial and non–financial) over the life cycle of the prison. This is particularly important because construction costs are only a minor portion of the total life–cycle costs of a facility. Without adequate cost–benefit analyses, Correctional Service does not know if it is applying its capital and operating resources in the most cost–effective manner.

16.66 Correctional Service is presently contemplating the retrofit of several prisons, including Ste–Anne–des–Plaines prison and the Saskatchewan penitentiary, once again without conducting the required life–cycle cost–benefit analyses. This could lead to life–cycle costs higher than those associated with new construction and could limit CSC's ability to increase its bed capacity.

16.67 Correctional Service of Canada and the Treasury Board should agree on a specific cost–benefit model and apply this model in evaluating all future accommodation projects of the Service. As a minimum, this model should:

- **identify all feasible options: retrofit, replacement, new construction and exchange–of–service arrangements with the provinces;**
- **assess the impact of double–bunking and shared–accommodation strategies;**
- **capture all capital and operating costs, including regional capital funds;**
- **assess both monetary and non–monetary benefits such as job creation; and**
- **apply appropriate life–cycle costing methodology, including the appropriate discount rates.**

CSC Response: *Correctional Service of Canada has already initiated work to develop an approval process and a guideline and checklist to ensure that life–cycle cost–benefit analyses of all feasible accommodation options, including double bunking, are both conducted and documented. By virtue of being life–cycle cost benefits, these analyses will include capital and operating costs. Regional capital funds will also be included, though by the nature of maintenance work, they will of necessity be an estimate only. Correctional Service does wish it understood, however, that while formal life cycle reports have not been produced, the availability of exchange–of–service agreement options and the assessment of operating costs, based on such things as analysis of the number of "posts" (staff) to operate a given design, are and have been factors routinely considered in retrofit decisions. These considerations are in addition to building condition surveys, facility development plans and renovation feasibility analyses.*

Is one inmate per cell still a realistic goal?

16.68 Until recently, Correctional Service has had a *de facto* policy of providing a single cell for each inmate in its custody. Historically, it considered double bunking "correctionally unacceptable" and viewed the practice as only a temporary measure. As a result, the Service has continued to plan and build cells designed for one inmate only. It has never considered shared accommodation as an alternative, or developed a written policy for the management of double bunking.

Ironically, despite its opposition to double bunking, the Service has been forced to double bunk an increasing number of inmates in small cells designed for one person.

Ironically, despite its opposition to double bunking, the Service has been forced to double bunk an increasing number of inmates in small cells designed for one person. Some of the cells that are currently double bunked are only about 60 square feet; others, including those at the Kingston and Saskatchewan penitentiaries, are as small as 48 square feet.

16.69 Correctional Service is planning to increase its capacity by more than 2,000 cells, at a total cost of about $470 million over the next five years. However, this additional capacity will not be adequate to accommodate the predicted increase in the numbers of inmates. The Service projects that, by the turn of the century, the number of double–bunked inmates will be about 30 percent across the prison system.

Correctional Service has proposed a double–bunking and shared–accommodation policy

Forced double bunking since the early 1980s has allowed Correctional Service to avoid a potential expenditure of about $240 million in one–time future capital costs.

16.70 Because of diminishing resources and an increasing inmate population, certain jurisdictions in the United States, including the U.S. Federal Bureau of Prisons and several state departments of corrections, have been forced to adopt a double–bunking policy with a view to increasing capacity and minimizing capital and operational costs. Studies by the U.S. General Accounting Office indicate that double bunking does not have a significant negative impact on the risk to inmate safety or public security. It found that if such a policy is carefully planned and implemented, negative results, including strains on common services and restricted programming capability, can be managed. However, the long–term impact of shared accommodation on correctional operations in the U.S. has not been assessed.

16.71 During the audit and at our urging, Correctional Service began to re-examine its accommodation policy and, specifically, double–bunking issues. As a result, it recognized that double bunking is no longer a marginal or temporary measure, and has proposed both double bunking and shared accommodation as viable, long–term strategies. The draft policy suggests that double–bunking and shared–accommodation options will be used where possible. Regions are encouraged to be both innovative and creative. Their goal is to make one quarter of all cells into double bunking or shared accommodation (the "one–quarter target") in each security level.

16.72 The draft policy also proposes that Correctional Service review the way it allocates its resources, recognizing that additional costs will be incurred for supervision, provision of services, work opportunities and treatment programs in prisons where double bunking and shared accommodation occur. First priority will be given to regional requests that have the most double–bunked and shared–accommodation cells. All new minimum and medium security accommodation will be built with cells suitable for shared accommodation.

The potential for cost avoidance could be substantial, but ...

16.73 If Correctional Service implements this new strategy of double bunking and shared accommodation, it could avoid spending large sums of capital funds constructing new prisons in the future. In fact, because of fiscal restraints and inmate population increases, the Service has been forced into double bunking since the early 1980s. This has allowed Correctional Service to avoid a potential expenditure of about $240 million in one–time future capital costs and to reduce operating expenses by

about $60 million annually, based on the number of inmates double bunked in 1993 (3,170). This amount is based on the estimates that, for each inmate double bunked, the Service can avoid a one–time construction cost of $150,000 and realize an annual saving in operating expenses of $38,000. The latter figure is based on CSC's data that show that the incremental cost of keeping a second inmate in a cell is $10,000 per year, compared to an average cost of $48,000 per year for single–bunked inmates.

16.74 If the "one–quarter target" in the proposed policy were applied to CSC's present capacity, it would create 900 additional beds immediately and would allow an additional 900 inmates to be double bunked. As a result, the Service could avoid further one–time future capital costs of $135 million and save $34 million more in operating expenses per year. When the Service applies this new policy to revise its long–range accommodation plan, it could lead to changes in some of the construction and expansion projects that are on the planning board. For example, the need for the construction of the new Ontario medium security prison, at a cost of $63 million, could be reassessed and possibly deferred or postponed.

16.75 There is a need to proceed with caution, however. The practices of double bunking and shared accommodation are a major departure from CSC's traditional philosophy. So far, few problems attributable to double bunking have been reported but many issues have yet to be assessed. In preparation, Correctional Service has formed a task force to address the following issues:

- the development of standards, guidelines and procedures for managing double bunking and shared accommodation in its institutions;
- provision of clear assumptions for long–range accommodation planning;
- development of resourcing formulae and funding strategies for double bunking and shared accommodation; and
- establishment of an evaluation framework for assessing the long–term effects of double bunking and shared accommodation on correctional objectives.

16.76 To make its proposed policy effective, Correctional Service will need to invest a portion of the capital costs avoided through the double–bunking policy to upgrade certain services, including sewer and water systems, and to provide additional staff, support services and programming funds. Therefore, the potential for capital avoidance and savings in operating costs will be dependent on the extent to which the Service is able to meet its "one–quarter target". It is currently conducting a prison–by–prison review to determine how the new policy will be implemented and what the precise financial and operational impacts of the policy will be.

16.77 In addition, other stakeholders, including employee unions and advocacy groups, have opposed any double–bunking policy and practice. Correctional Service will need to address their concerns.

Correctional Service of Canada needs to review its exchange–of–service policy

16.78 By signing exchange–of–service agreements (ESAs) with the provinces, the federal government secures additional accommodation spaces in provincial prisons to house federal inmates. The use of these agreements increased dramatically in 1986. There were a number of reasons for this —

overcrowding in federal prisons, a moratorium on the construction of new federal prisons due to general fiscal restraint within the federal government, and increased priority on federal–provincial co-operation. Since then, ESA payments have soared — from $1.8 million in 1986–87 to about $20 million per year today.

16.79 The agreements add about 500 beds (or about four percent) to CSC's capacity. However, the average use has dropped to about 270 beds in 1992–93, with the greatest decrease in the Prairie region. This means that one half of the beds subject to ESAs have not been used effectively, while overcrowding remains a problem in the federal system. Furthermore, in the last three years, about $2 million has been paid for beds in the Ontario and Pacific regions that were guaranteed but have not been used by Correctional Service.

16.80 Correctional Service informed us that it established with the Treasury Board, in 1992, operational guidelines for the management of all exchange–of–service agreements. As each ESA becomes due for renegotiation, the Service will conduct a comprehensive review, including cost–benefit analysis, to determine the level needed from that ESA to support its long–range accommodation requirements.

Capital and accommodation planning processes need to be better integrated

16.81 In 1986, we observed that Correctional Service had given the regions more autonomy to plan for their own accommodation needs. However, the planning process, as a whole, was neither centrally monitored nor controlled. A national unit to co–ordinate the planning process now exists but co–ordination still needs to be improved.

16.82 The responsibilities for accommodation planning continue to be distributed among several organizational units within Correctional Service:

- Research and Statistics provides multi–year population forecasts.
- Regions determine capacity shortfalls and develop regional plans to address any shortfalls that may exist.
- Operational Planning and Resource Analysis assesses regional plans and develops the long–range accommodation plan.
- Technical Services plans, constructs and maintains facilities.
- Correctional Operations plans and manages the exchange–of–service agreements, an integral part of the accommodation strategy.

16.83 In terms of financial responsibility, Technical Services controls most of CSC's capital funds, which grew from $92 million in 1987–88 to $140 million in 1993–94. The regions control about one quarter of that total for minor projects. They use the funds to preserve CSC's capacity by maintaining, repairing, modifying or restoring existing facilities.

16.84 In summary, although the responsibilities for the management of accommodation planning and control of capital expenditures have been specified, the overall authority has not been clearly assigned to any one unit.

16.85 Correctional Service of Canada should designate a full–time senior executive to be responsible for all accommodation–related functions, including capacity planning, capital budgeting and the development of a clearly articulated master

accommodation and capital expenditures plan.

CSC Response: *The Correctional Service of Canada is in the process of conducting a major downsizing and reorganization, one feature of which is a better integrated corporate planning process under a single head. Accommodation planning is part of this exercise. The resultant plans will include life–cycle cost estimates in support of accommodation options.*

16.86 Once the new double–bunking and shared–accommodation policy is formally adopted, Correctional Service should revise its long–range accommodation plan to reflect the principles of this new policy.

CSC Response: *This will be done. In the interim, the current long–range accommodation plan is being prepared based on anticipated levels of double bunking and shared accommodation.*

Cost–Reduction Initiatives

Correctional Service is taking steps to reduce overtime and other administrative costs

16.87 In our 1986 Report, we observed that Correctional Service did not have the means to measure and control the use of overtime in its institutions. It has since implemented an overtime management system and reduced its overtime cost from 9.5 percent of its total salary expense in 1985 to about seven percent in 1993.

16.88 As part of the incremental, across–the–board budget reductions, CSC's contribution to fiscal restraint measures is $83 million from 1992 to 1997. Accordingly, as of July 1993, Correctional Service has launched a comprehensive review of all areas of its management, administration and operations. The review includes an examination of the roles and structures of national and regional headquarters, management processes, legal and regulatory requirements, facility modifications and program and service delivery. The review is expected to result in changes that will mean savings of about $83 million.

16.89 In addition, the Service has undertaken a study to develop methodology to allocate resources on a more equitable basis among its various operating units. CSC's efforts will ensure better utilization and greater efficiency and we support them.

Chapter 17

National Parole Board

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National Parole Board

Assistant Auditor General: David Rattray
Responsible Auditor: David Brittain

Main Points

17.1 On an average day, there are approximately 6,500 federal offenders serving a portion of their sentence in the community on day or full parole. The National Parole Board, established in 1959, is responsible for authorizing the release of these offenders on parole. National Parole Board members have a very difficult job to do. Six to eight times during a day of hearings, Board members must attempt to assess whether an offender's risk is manageable in the community. This assessment is complex and crucial – particularly in light of the general acknowledgement that it is difficult to predict, with any certainty, whether an offender will commit another offence after release. Moreover, before making their decision, Board members have only a short time to read and digest large amounts of information on the offender, some of which may be incomplete or even contradictory.

17.2 **Good members are essential.** Given the importance of the job, it is essential that the Board have good members. Thus it is also essential that the selection process be open to all suitable applicants, with selection based upon the applicant's skills and abilities. While improvements have been made to the selection process, in our view it could be strengthened further. Specifically, it is important that part–time members be subject to the same selection process as full–time members. In addition, the government requires professional advice on the suitability of applicants for appointment to the Board.

17.3 **The Board needs to review its operations.** How the Board operates contributes directly to the quality of the decisions it makes. Accordingly, we believe that the Board needs to ask itself a number of key questions about its operations:

- What on–the–job training could it provide to members that would help them to better meet their responsibilities?
- How can it evaluate how well Board members are performing on an individual level?
- What information and feedback does it need to provide to members on the outcome of their decisions?
- What is the best way to ensure that individual members and the Board as a whole can learn from past mistakes, and what can be done to identify and deal with recurring problems?
- How is it measuring its performance, and could it develop better or more comprehensive measures to assess how well it is doing (the quality of decisions)?
- Is the time allocated to dealing with a given offender related to the risk he poses to the community?
- Does it know enough about using current models for predicting risk?
- Given that information is the cornerstone of its work, what can it do to reduce the quantity and improve the quality of information that Board members receive?

We believe that carefully considered answers to these questions would contribute greatly to improving the operations of the National Parole Board.

Introduction

17.4 On an average day in Canada, more than 9,000 offenders are serving the final portions of their federal criminal sentences in the community. Approximately 6,500 of these offenders were released on parole by the National Parole Board. The remaining 2,500 offenders were released automatically, by law, after having served two thirds of their sentences.

17.5 The decisions to parole offenders are made by up to 45 full–time members of the National Parole Board as well as part–time Board members (complement of 62 in May 1994). All are appointed by the Governor in Council. A support staff of 300 employees located at national headquarters and in five regional offices assists them in carrying out their duties (see Exhibit 17.1). In 1994–95, the total budget for the National Parole Board is $25.8 million.

17.6 The National Parole Board is one element in the Canadian criminal justice system. Many others may have dealt with an offender before he faces the Board, including teachers, social workers, psychologists, police, Crown attorneys, judges, provincial prison staff, provincial probation and parole officers and Correctional Service of Canada penitentiary staff (see Exhibit 17.2).

(In this document we refer to offenders in the masculine form. This reflects the profile of federal offenders; about 98 percent are male.)

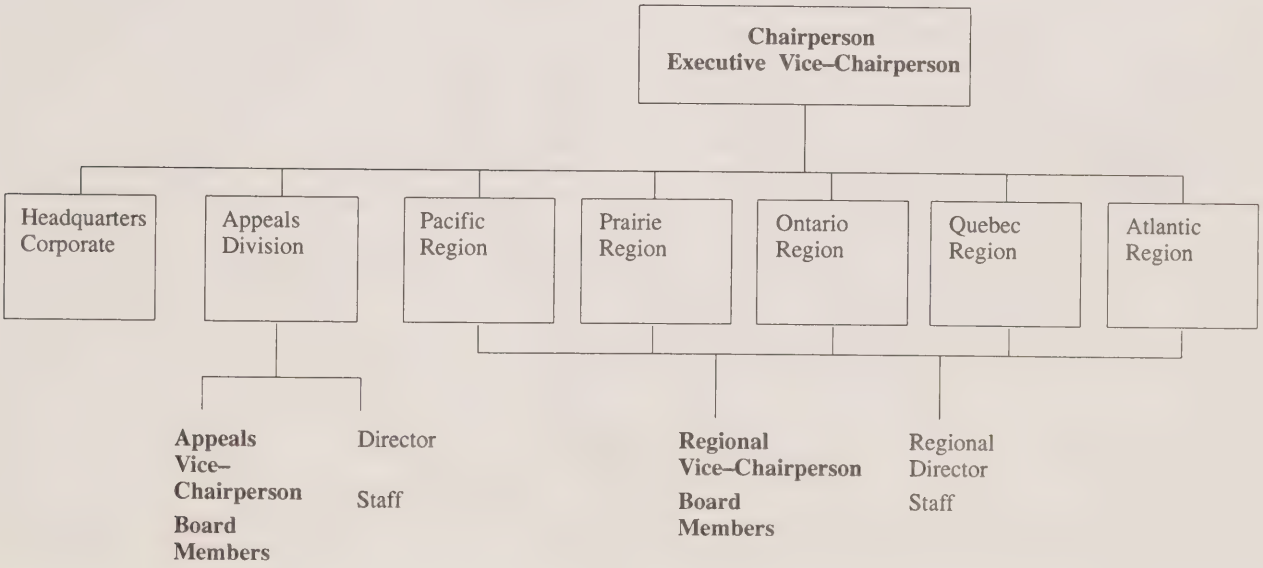
17.7 The National Parole Board is an independent administrative tribunal. Under the *Corrections and Conditional Release Act*, enacted in 1992, the National Parole Board has the authority to:

- grant parole or temporary absences to federal inmates;
- establish conditions for temporary absences, parole and statutory release;
- revoke any release if the offender does not abide by the conditions of

The National Parole Board is one element in the Canadian criminal justice system. Many others may have dealt with an offender before.

Exhibit 17.1

National Parole Board



The Board relies on the Correctional Service for most of the information it receives concerning offenders.

release, reoffends, or is likely to reoffend; and

- order an offender detained in prison until the end of his sentence.

Historically, most offenders have spent part of their sentence in the community

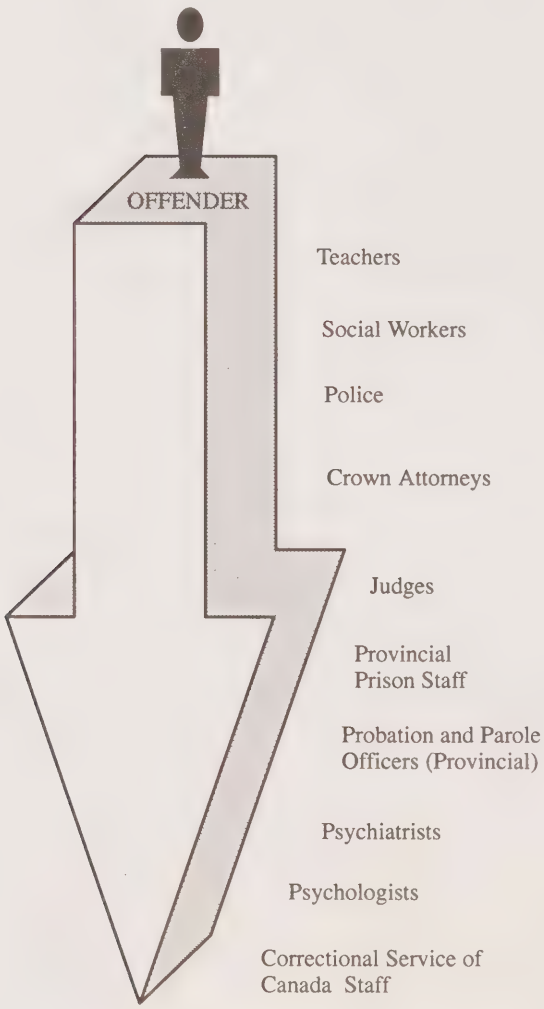
17.8 Parole was introduced to Canada with the enactment of the *Ticket of Leave Act* in 1899. This legislation gave broad discretionary powers to a Minister of the Crown to grant parole. Over the years, parole has been granted for a variety of reasons: to show mercy, facilitate rehabilitation and allow for a supervised transition back into the community.

17.9 In 1959, the National Parole Board was created and given the authority to grant parole. The Parole Board was originally associated with the National Parole Service, which was established to provide case preparation and parole supervision. In 1977, the National Parole Service was merged with the Canadian Penitentiary Service to form the Correctional Service of Canada. This left the National Parole Board as an independent decision–making body. The Board relies on the Correctional Service

Exhibit 17.2

National Parole Board, One Part of Process

Before facing the Board, an offender may have been seen and assessed by many other professionals.



for most of the information it receives concerning offenders, and for the supervision of offenders in the community. Therefore, it is important that they have a good working relationship.

17.10 In addition to parole, other forms of early release are available to offenders in Canada. An offender is released automatically after serving two thirds of his sentence. This form of release, called statutory release, was introduced by the *Corrections and Conditional Release Act* in 1992. Statutory release replaced forms of release in existence since 1868. An offender can also be released by authority of the Governor in Council on the basis of clemency via the Royal Prerogative of Mercy. This form of release, in existence since Confederation, is used infrequently today.

Most offenders will be released eventually

17.11 When handing down a prison sentence, a judge will generally specify the length of that sentence. In 1992–93, 84 percent of offenders in federal penitentiaries had sentences with a fixed term. For these offenders, release is, generally, automatic at the statutory release date (a small proportion of offenders are held in custody until the end of their sentence). The National Parole Board may authorize release of offenders prior to the statutory release date as shown in Exhibit 17.3.

17.12 The remaining 16 percent of inmates had life or indeterminate sentences. For these offenders, release is completely at the discretion of the National Parole Board. They could, presumably, spend the rest of their lives in a penitentiary.

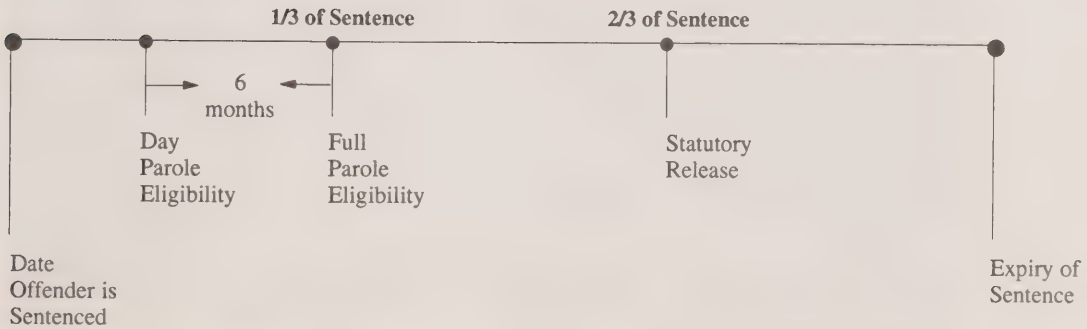
17.13 Board members may grant parole if, in their opinion, the offender will not pose an undue risk to society while on parole and parole will help the offender's reintegration into society. In making a decision whether to parole an offender, safety of the public is the paramount consideration.

The National Parole Board conducts approximately 24,000 reviews of federal offenders a year

17.14 The National Parole Board conducts approximately 24,000 reviews of federal offenders a year (based on 1992–93 records). These are either "paper" or "panel" reviews. The former is

Exhibit 17.3

Milestones in the Sentence of an Offender with a Fixed–Term Sentence



The decision to release an offender is often based upon work done by two Board members in two to three hours each.

a review of the documentation provided by the Correctional Service. The latter includes a review of that documentation and an interview with the offender.

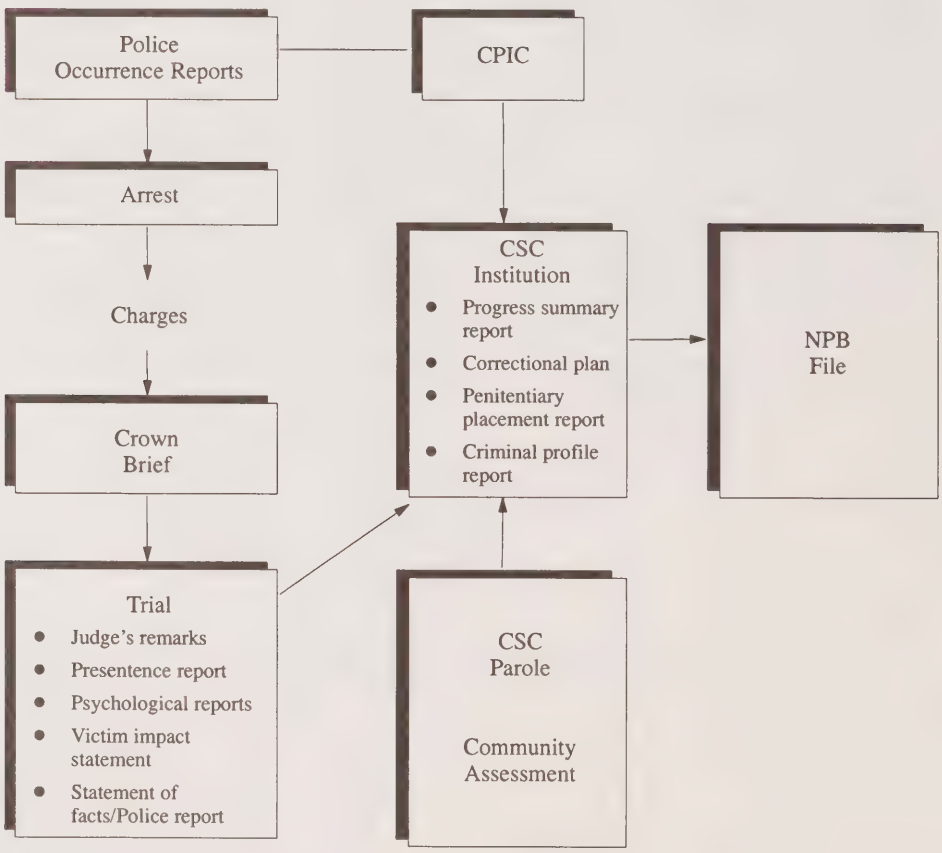
17.15 Reviews can be divided into three basic categories:

- pre–release reviews: after which the offender may be released;
- detention reviews: after which the offender may be ordered kept in prison until the end of his sentence; and
- post–release reviews: after which the offender's release may be revoked or the release conditions changed.

17.16 The National Parole Board creates a file for each offender, which contains information prepared by a variety of agencies. Information generated by police agencies concerns the preparation and laying of criminal charges. Other information, originating from Crown attorneys and the courts, includes trial transcripts, victim impact statements, presentence reports and judges' sentencing remarks. A record of the offender's criminal history, including convictions and dropped charges, comes from the Canadian Police Information Centre. The Correctional Service prepares information and analysis on the offender's past and present behaviour, and forwards it to the National Parole Board for inclusion in the file (see Exhibit 17.4).

Exhibit 17.4

Information Flow



CPIC – Canadian Police Information Centre
CSC – Correctional Service of Canada
NPB – National Parole Board

Parole release decisions are often based on two to three hours work by Board members

17.17 The pre–release hearing is the most common review. An offender seeking parole appears before a panel of two or more Board members in the penitentiary where the offender is serving his sentence. Before meeting the offender, Board members review the information on file in the National Parole Board offices. They spend from one to one and a half hours the day before the hearing reviewing each file. The hearing lasts a similar length of time. Therefore, the



An offender seeking parole will appear before a panel of two or more Board members in the penitentiary where he is serving his sentence (see paragraph 17.17).



Before meeting the offender, Board members review the information on file in the National Parole Board offices (see paragraph 17.17).

Members grant parole knowing that some released offenders could commit crimes of violence. They deny parole knowing that spending additional time in a penitentiary could make eventual release even riskier.

decision to release an offender is often based upon work done by two Board members in two to three hours each.

17.18 Board members normally hear six cases a day, although this may vary by region and type of review. The Prairie region, for instance, schedules eight hearings a day because of greater travel distances.

17.19 At the hearing, Board members interview the offender and Correctional Service staff to determine whether the offender can be safely managed in the community. There are no prescribed rules of evidence or limits on the information that Board members may consider. However, information must be pertinent to assessing both the likelihood that an offender will re-offend and the risk that the offender presents to the community.

17.20 In assessing an offender's suitability for release, Board members are guided by the National Parole Board Decision Policy developed in 1988. Board members must consider certain factors, such as:

- details of the offence, criminal history record and role of drugs or alcohol;
- whether the offender has taken programs in the institution to help him deal with the problems that led to his criminal behaviour;
- whether the offender has sufficient understanding of his criminal behaviour; and
- whether the proposed release plan can adequately control the offender and help deal with his needs.

17.21 In making their decision, Board members are bound by the duty to act fairly. Offenders are to be provided with the information used to make the decision, the reasons for the decision, as well as the opportunity to appeal any decision.

Making parole decisions is difficult

17.22 The decision to parole an offender is a difficult one. Board members grant parole knowing that some released offenders could commit crimes of violence. Yet, they deny parole knowing that spending additional time in a penitentiary could make the offenders' eventual release to society even riskier.

17.23 Making decisions about whether or not to grant parole involves review of files of large quantities of information concerning offenders. This information is, at times, contradictory, confusing and unclear. Board members review the files and note the key risks and needs of the offender. They must assess the recommendations of corrections professionals as to the suitability of an offender for parole.

17.24 Each offender has a different story and different needs, and will present different risks to the community. Many offenders will have built up a case for parole based on their behaviour in the penitentiary. Board members must consider that good institutional behaviour is a poor indicator of behaviour on parole. Many offenders are unable to express themselves clearly, and Board members must phrase their questions and interpret responses carefully to properly understand these individuals and their concerns. At the same time, Board members must be wary of offenders who are able to answer questions convincingly while downplaying the level of their criminal behaviour.

Parole Board decisions have agreed with Correctional Service recommendations 85 to 90 percent of the time.

17.25 Board members grant day parole twice as often as they deny it. The reverse holds true for full parole (see Exhibit 17.5). National Parole Board decisions have agreed with Correctional

Service recommendations 85 to 90 percent of the time.

17.26 When released on parole or statutory release, an offender must report to the Correctional Service parole office in the area where he goes upon release. The parole officer must monitor the offender's behaviour to ensure that he has not become an unacceptable risk to the community. The parole officer is also responsible for helping the offender reintegrate into the community as a law–abiding citizen. If the offender either breaches the conditions of his release, or commits another offence, the parole officer can suspend his parole or statutory release and return him to custody. Subsequently, the parole officer can cancel the suspension or return the offender to a federal penitentiary, where a review will be held by the Board to decide if the offender will be allowed to continue his release in the community.

Most parolees never return to federal penitentiary

17.27 During the ten–year period ending 31 March 1988, there were 17,444 full parole releases of which 26 percent were revoked. In comparison, during the same period, there were 29,458 statutory releases of which 46 percent were revoked (see Exhibit 17.6). Releases are revoked for a variety of reasons, including a return to criminal activity, a breach of a release condition or as a preventive measure.

17.28 Some of the offenders who have incurred new charges while on parole or statutory release have been charged with crimes of violence. A National Parole Board analysis shows that, from 1975 to 1986, 130 offenders committed homicide while on full parole or mandatory supervision (the precursor of statutory release). Of those offenders, 32 percent were parolees.

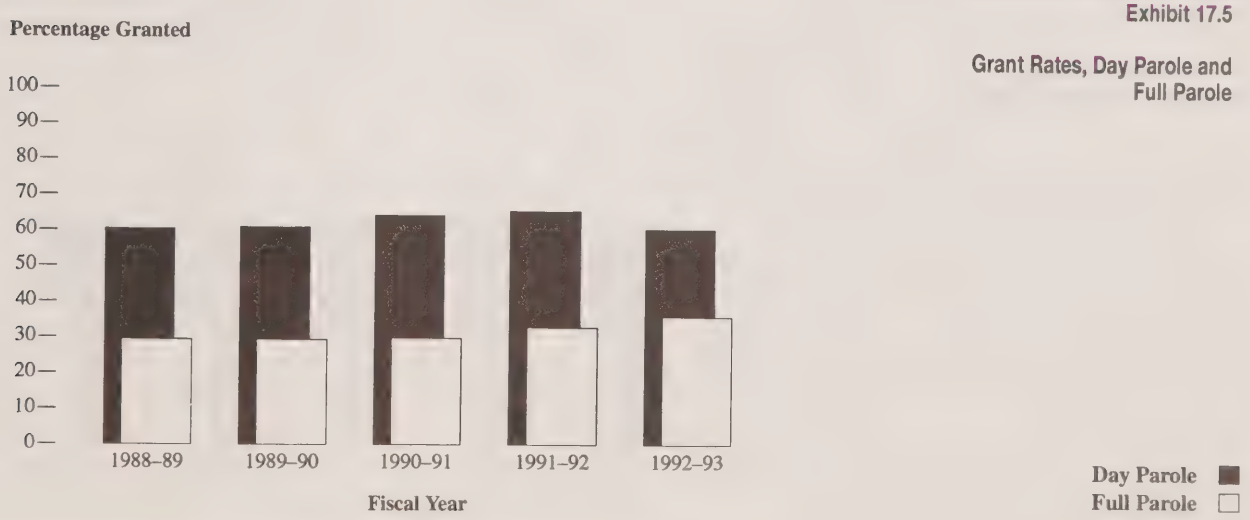
17.29 Although the National Parole Board may be able to improve its process over time to lessen the likelihood of a parolee committing a crime, no system will be able to eliminate reoffending.

National Parole Board's general comments

Chapter 17 of the Auditor General's Report provides a clear outline of the operations of the National Parole Board. It recognizes the complexity of the task performed by its members and supports the notion that even

Exhibit 17.5

Grant Rates, Day Parole and Full Parole



though no exercise of human judgment can ever be infallible, it is essential to ensure the best possible appointment process, the appointment of the most qualified candidates, good training programs, and well-defined policies and procedures to support the decision–making process. It also offers practical and pertinent recommendations to improve the quality of decision–making functions and to improve the process for arriving at the best decisions possible.

Several of the recommendations contained in the Auditor General's Report raise issues about which the Chairman has made comments since his appointment. The National Parole Board considers this analysis as an opportunity to be pro–active since, in its view, the recommendations are extremely pertinent and relevant to the areas that need to be addressed.

Audit Scope

17.30 The audit of the National Parole Board focussed on whether the Board has the members, information and management systems necessary to carry out its mandate concerning public safety. Particular emphasis was placed on the assessment of risk to public safety by the Board. The audit addressed the following questions:

- Does the selection process provide the Board with suitable members?
- Are Board members properly trained?
- Are Board members given appropriate feedback on their decisions and is their performance properly evaluated?
- Does the National Parole Board receive adequate information (including mental health and young offender records) from the Correctional Service, police, courts and others to enable it to make effective decisions?
- Does the National Parole Board have adequate information to assess its performance?

17.31 The National Parole Board's responsibility includes provincial offenders in seven provinces and two territories. Our audit did not examine this aspect of the Board's operations.

Exhibit 17.6

Rates of Revocation of Releases 1983–84 to 1987–88



Observations and Recommendations

Appointment and Development of Board Members

The best–qualified people need to be appointed to the National Parole Board

17.32 There is public concern that the process for appointing Board members has resulted in the appointment of some who do not have the abilities and skills needed to do the job. In our audit of the National Parole Board we did not examine the quality of the current complement of Board members. We did, however, consider whether the appointment process was the best possible for the selection of capable Board members.

17.33 The work of the Board is demanding and often involves high–risk decisions. Board members exercise significant influence on public safety each time they make a decision to parole an offender. In making decisions, Board members must be able to analyze documents prepared by corrections professionals, weigh various professional opinions, interview offenders and arrive at an independent decision and support it in writing. Furthermore, they have only two to three hours per case to carry out their tasks and decide whether to release an offender.

17.34 Board members are Governor–in–Council appointments selected "to hold office during good behaviour" for periods as long as 10 years. The legislation in effect at the time of our audit makes it difficult to dismiss Board members. In fact, no member has ever been formally dismissed. Legislation currently before the House of Commons proposes the creation of a dismissal mechanism. All of these factors emphasize the need to appoint only the best–qualified people to the Board in the first place.

17.35 In order to bring forward the best-qualified people, it is important that the process be open and based on merit. Openness increases public awareness and gives suitable candidates a chance to be considered for appointment. A process based on merit fosters the selection of people capable of making crucial decisions concerning parole.

17.36 There has been a public perception that the selection process was closed and not necessarily merit–based. While many good appointments have been made, there is the appearance that some members were selected because of factors unrelated to their ability to do the job.

17.37 National Parole Board officials told us that the process has not consistently provided the Board with suitable members. The Board has had to compensate for members who do not have the experience and skills necessary to do the job. We noted, for example, that the scheduling of panel hearings attempts to ensure that "weak" members are teamed with "strong" members whenever possible. However, the heavy workload of Board members often makes such scheduling difficult. Thus, there is no guarantee that weak Board members will not decide on difficult cases.

17.38 In the fall of 1993, the government made a number of changes to the process. Board member vacancies are now advertised in the Canada Gazette, and advertisements contain broadly defined criteria. Job–specific criteria were also developed to screen candidates. We were further advised that this new process was used to choose full–time Board members in 1994, all of whom have a criminal justice background.

It is important that the process be open and based on merit. There has been a public perception that the selection process was closed and not necessarily merit–based.

In the fall of 1993, the government made a number of changes to the process.

17.39 While there is no requirement to interview candidates, parliamentarians can call appointees before the House of Commons Standing Committee on Justice and Legal Affairs (Committee) to examine their qualifications. We observed that one of the most recent appointees selected in 1994 had appeared before the Committee. Although the Committee has no authority to veto an appointment, it does provide a forum for external scrutiny of appointees.

17.40 While we are encouraged by these changes, we believe that more improvements are needed. For example, the changes to the appointment process need to also apply to part–time members, since they make a significant portion of the decisions.

17.41 There are other agencies and tribunals that currently seek recommendations on the competence of applicants. For example, the government receives independent advice from a committee on the suitability of applicants for appointment to the federal judiciary. We noted that a committee was struck in the selection of the present Chairperson of the National Parole Board. We were encouraged by this initiative, as such an approach can provide the Minister with the best possible advice on appointments.

17.42 The government should continue to build on current improvements to the appointment process by seeking professional advice on the suitability of applicants to ensure that the process is open and merit–based. As well, the same selection process should apply to part–time members.

Board's response: *Board Members are appointed by the Governor in Council and, to that extent, the National Parole Board does not make final decisions on the appointment process.*

However, we would like to describe the process that was followed for the recent appointment of the National Parole Board's Chairman. The appointment resulted from a rigorous selection process that involved the publication of the vacancy in the Canada Gazette, followed by an initial interview with short–listed candidates by a three–member selection Committee of senior government officials, and a personal interview of finalists by the Solicitor General who subsequently submitted his recommendation to the Governor in Council.

A similar process is being set up for the appointments of full–time and part–time members; in addition to the process already initiated of advertizing full–time positions in the Canada Gazette, we are now reviewing all applications for full–time as well as for part–time appointments against the identified criteria, with particular emphasis on knowledge and experience in the criminal justice system. Subsequent to this initial screening, all short–listed candidates will be interviewed by a selection committee composed of senior government officials, including the Chair or the Executive Vice–Chair of the National Parole Board. The names of the most qualified candidates, in the committee's view, will be referred to the Solicitor General for consideration and recommendation to the Governor in Council.

Furthermore, the National Parole Board is now seeking professional advice in refining the selection criteria and developing a framework and guidelines for the personal interviews with the selected candidates. We wish to ensure that the interview will indeed serve to identify the candidates with the best experience, expertise and skills required to perform the difficult task of risk assessment.

Orientation of Board members needs to be improved

17.43 Many Board members have had no previous experience in the criminal justice system. To do their jobs effectively, new Board members need two types of information. First, they need a knowledge of the Board's operation, the mechanics of the parole hearing process and their role and responsibilities. Second, to understand the predictions and assessments of corrections professionals, they require knowledge of the criminal justice system and behavioral sciences.

17.44 When they are appointed, Board members receive a comprehensive orientation binder. It contains materials on the mandate of the National Parole Board and the role and responsibilities of Board members. It also includes materials on current issues in criminal justice and the behavioral sciences. The contents of the binder form the key element of a study program that is self–taught, with guidance from a regional trainer.

17.45 New Board members have two weeks to study and assimilate the materials contained in the orientation binder. We were informed by Board members that a two–week period is only enough time "to master the basic survival skills", which include understanding the mandate of the National Parole Board, the roles and responsibilities of Board members, and the mechanics of conducting a hearing. It is highly unlikely that background information on the criminal justice system and the behavioral sciences can be absorbed in this limited time. As well, Board members are given limited exposure to penitentiaries, parole offices and half–way houses prior to starting their duties.

17.46 After the orientation period, new Board members sit in on hearings as observers, and then are teamed with experienced Board members. The National Parole Board provides Board members with ongoing training based on perceptions of their general needs. For example, in the spring of 1994, all Board members received a three–day course on risk assessment. Other training initiatives have focussed on topics such as family violence and aboriginal issues. However, these sessions are not directed to the needs of individual Board members. As a result, they can not necessarily compensate for deficiencies in the knowledge and skills of individual members.

New Board members have two weeks to study and assimilate the materials contained in the orientation binder.

17.47 The National Parole Board should strengthen the development of Board members through improved training. Training should attempt to ensure that, before commencing their duties, Board members gain the appropriate knowledge of their role and responsibilities, the operations of the Parole Board, the criminal justice system and relevant behavioral sciences.

Board's response: *The National Parole Board agrees fully with the recommendation. It is expected that the enhanced selection process introduced by the government and supported by the Board's new interview process will result in the appointment of more Board members who already have some knowledge of the criminal justice system and relevant behavioural sciences, and that the training will be focussed increasingly on risk assessment in regard to specific types of offenders.*

The government has made a commitment to enhanced training for Board members, as reflected by the Minister's statement in tabling proposed amendments to the Corrections and Conditional Release Act *(Bill C–45). The Chairman of the Board has reinstated national training sessions, which provide an opportunity for the members from all five regions to meet for professional development purposes. The*

next session will take place in February 1995.

The Board has given considerable attention to the issue of training in the recent past. We have developed a series of training modules and adopted a national training framework that has increased the initial orientation program for Board members from five days to ten days. All regions conduct Board members' continuing training workshops during the year and, in the fiscal year 1993–94, a three–day training session, based on a behavioural science approach to risk assessment, was provided within each region, to all full–time and part–time Board members.

The training of newly appointed Board members, and their ongoing training and professional development, have normally been resourced from within the Board's existing budget levels. We recognize the need and benefit of increasing training opportunities and we will continue to seek improvements in this regard. However, without the provision of additional resources, the Board will be unable to achieve fully the desired results that further training would promote.

The Board lacks mechanisms to provide members with feedback on their decisions

17.48 Board members require feedback on their performance to encourage them to develop their decision–making skills. This feedback should include measures that promote self–assessment of decisions, as well as an appraisal process. Currently, feedback is extremely limited. If an offender commits a violent offence while on parole, the Board members involved will be acutely aware of that case. However, Board members do not generally hear about less spectacular parole "failures" except through post–suspension hearings. Success stories are rarely reported.

17.49 We found that in the Pacific region, some progress has been made in providing ongoing feedback. Board members are informed of an offender's status six months after parole is granted. Members are told whether the offender is still on parole, or has successfully completed parole. If the offender has been returned to federal custody, that fact is reported along with the circumstances surrounding his return.

17.50 The National Parole Board should develop mechanisms to provide feedback to Board members, including information on their successes and failures.

Board's response: *The National Parole Board is in full agreement with the recommendation and recognizes that it needs to ensure that Board members have access consistently to information on the outcome of the decisions they have rendered. With the support of the new Offender Management System, we are in the process of developing a Management Information System that will assist in this regard.*

While the recommendation is very pertinent, we would like to stress that the successes *or* failures *of offenders released to the community are not always and exclusively the result of Board members' decisions. The quality of the information that is available to the members at the time they render the decision, the quality of the supervision provided in the community, as well as the offender's ultimate choice to lead a law–abiding life or to return to a previous pattern of criminal behaviour are all factors that impact the ultimate* success *or* failure *of the offender's time on conditional release.*

It is recognized that in developing mechanisms to better inform Board members, as well as the organization in total, both individual and corporate performance will be enhanced.

The performance of Board members needs to be appraised

17.51 The National Parole Board has no formal system for appraising Board members. As a result, it does not appropriately identify and deal with Board members who are not performing properly. At one time, an appraisal process existed, but it was abandoned because evaluations were considered to have no impact on poor performers. This is partially due to Board members being appointed "to hold office during good behaviour."

17.52 The *Corrections and Conditional Release Act* establishes the position of Vice–Chairperson for each division of the Board. These individuals are responsible for "the professional conduct, training and quality of decision–making of the Board members" assigned to their region. However, the Vice–Chairperson, like other Board members, is a Governor–in–Council appointee and has no additional powers to support the role of Vice–Chairperson. As a result, a Vice–Chairperson has limited authority over other Board members. This is particularly true where the Vice–Chairperson's connections with the government are considered weaker than those of the Board member to be appraised.

17.53 In the absence of a formal appraisal system, informal mechanisms for assessing Board members' performance are used. In the Quebec region, for example, the Regional Vice–Chairperson attends hearings to evaluate the Board members conducting the hearing. In other regions, the Regional Vice–Chairperson or Regional Director (see Exhibit 17.1) evaluates performance by reviewing written decisions or listening to tapes of hearings.

17.54 The National Parole Board should establish a formal mechanism to evaluate Board members' performance on an annual basis.

***Board's response**: The National Parole Board agrees with the recommendation. In June 1993, the National Parole Board adopted the following mandate for its newly established Professional Standards Committee:*

- *to develop and maintain a code of ethics and professional conduct;*
- *to advise on the Board's professional training and development program, training standards, and the Board's annual training plans;*
- *to establish mechanisms to support the Vice–Chairperson's responsibilities for quality control and for monitoring and evaluating the training needs of members; and*
- *to advise on the planning and priorities for national Board training and professional standards workshops.*

A draft code of professional conduct has been approved and we are currently in the process of developing specific performance criteria and appraisal mechanisms so that the performance of all Board members will be evaluated once every year.

The National Parole Board has no formal system for appraising Board members.

Improving the Quality of Board Decisions

17.55 In 1988, the House of Commons Standing Committee on Justice and Solicitor General noted that "the National Parole Board is only as good as its decisions." To improve the quality of its decisions, the Board needs to learn from its past successes and failures. It also needs good measures of its performance. As well, it should assess the feasibility of improving its decision–making process. Our audit has suggested that

improvements in all three areas may aid the Board in its efforts to continuously improve the quality of its decisions.

We examined 63 of these investigations and found them to be comprehensive and rigorous attempts to detect problems and determine their underlying causes.

Lessons learned from investigations of individual decisions require wider distribution

17.56 The National Parole Board, by itself or with the Correctional Service, investigates decisions involving the release of offenders who commit high–profile, violent offences while on parole. These investigations are designed to identify causes of problems and to propose needed improvements. In our audit, we examined 63 of these investigations and found them to be comprehensive and rigorous attempts to detect problems and determine their underlying causes. Conclusions and recommendations were communicated to those involved in the cases, and attempts were made to change policies and procedures if appropriate. However, the National Parole Board does not communicate the lessons learned from these investigations to all Board members. Thus we question whether the full benefit of the investigations is being realized.

17.57 There have been some limited attempts to provide Board members with this type of information. For example, in the Ontario region, during a training session on risk assessment, two investigations were used as case studies for identifying potential risks. Such efforts are valuable in improving risk identification.

However, the Board does not systematically review all investigations to determine whether problems are recurring from investigation to investigation.

17.58 The National Parole Board should clearly and concisely communicate significant lessons learned from its investigations to all Board members.

Board's response: *The National Parole Board agrees with the recommendation and recognizes that we need to have a more consistent approach to communicate the lessons learned from the investigation reports. Currently, reports on investigations and inquiries are reviewed by a Case Audit and Review Committee, which adopts an action plan for each recommendation. We are now in the process of developing a comprehensive plan that will serve to ensure that all such reports are not only distributed more consistently to all Board members and staff, but that they are also discussed with the members and used as training aids. We shall also ensure that the results of investigations that reference the Board's policies and operations will be carefully reviewed.*

The National Parole Board does not examine all investigations to identify recurring problems and systemic weaknesses

17.59 After an investigation has been completed, the National Parole Board does a follow–up to ensure that the resulting recommendations have been implemented. However, the Board does not systematically review all investigations to determine whether problems are recurring from investigation to investigation.

17.60 In our examination of 63 investigations conducted by the Board, we determined that a number of broad factors had reappeared in certain incidents over several years, including:

- flawed decision making by Board members;
- inadequate use of risk–assessment techniques; and
- lack of adequate information from police, courts or the Correctional Service.

17.61 The National Parole Board should institute a review of all past investigations as a management tool to improve identification and treatment of

recurring problems or systemic weaknesses.

Board's response: *The National Parole Board agrees with this recommendation. We are currently in the process of conducting a comprehensive review of all reports from internal investigations and Boards of inquiries to identify areas that need to be addressed by way of policy or training. The results will be circulated to all Board members and will also be used for reference in the appraisal of Board members.*

The National Parole Board needs to develop better ongoing performance measures

17.62 The National Parole Board has limited measures of its performance. As a result, it is difficult for the Board to assess the success of its decisions or identify areas where improvement is needed.

17.63 We noted earlier that the Board conducted an analysis of offenders convicted for homicides committed while on full parole or statutory release from 1975 to 1986. That analysis is not regularly updated, though the Board is now undertaking a similar study. There is currently no management information system in the Board that provides this type of information on an ongoing basis.

17.64 The National Parole Board's main measure of performance is the rate of recidivism. The definition of recidivism most relevant to the Board is the return of an offender to federal penitentiary by revocation of parole or statutory release. As the overall recidivism rate has remained roughly stable throughout the 1980s, it may be too broad an indicator to be truly helpful to management.

17.65 We suggest that the National Parole Board could develop other performance measures that would better enable management to determine if Board members are making "good" decisions. These measures could include:

- recidivism rate for the first year after release;
- recidivism rate by type of revocation (for example, breach of conditions, non–violent reoffence, violent reoffence);
- recidivism rate by category of offender;
- recidivism rate by region;
- recidivism rate for cases where the National Parole Board releases an offender, though the Correctional Service has not recommended release;
- violent crimes committed while offenders are on release; and
- successful completions of release.

17.66 In addition, these measures should be placed in context by comparison to other jurisdictions, to the general population and over time. These changes would permit effective monitoring of the Board's performance on an ongoing basis.

17.67 The Board together with the Correctional Service have developed the Offender Management System, which was designed, among other things, to provide the Board with the management information it requires. Difficulties involving its implementation to date have not allowed it to fulfil this necessary function.

17.68 The National Parole Board should develop better measures of its performance.

Board's response: *The National Parole Board agrees with this recommendation. We have already developed a comprehensive document that identifies the information required by management to assess our performance. We are working with the Correctional Service of Canada to resolve the problems with the*

The National Parole Board could develop other performance measures that would better enable management to determine if Board members are making "good" decisions.

Offender Management System in order that we may better utilize its intended applications.

The National Parole Board needs to review its operations

17.69 The Board needs to review many aspects of its operations to improve its decision making. The Board may have become a "prisoner" of its own files, and it needs to look for better ways to do its work. Given the workload of the Board, it is important that it focus its resources on those cases that most warrant them. In its scheduling, the Board provides additional time for offenders with life sentences and those referred for detention. For the remainder, the amount of time and effort is dependent on the discretion of the individual members assigned.

17.70 During our audit, we were unable to find evidence that Board members consistently focus their efforts on higher–risk cases. In fact, our observations showed us that Board members may spend as much time and effort on a non–violent offender with a short sentence as they spend on a violent offender with a long sentence. Therefore, we believe that the Board needs to review its operations in a number of fundamental areas. In so doing, the Board might want to consider:

Any efforts to increase information must be combined with an attempt to structure it in a way that facilitates decision making.

- How can the identification of high–risk cases be improved to better focus effort and skills on those cases?
- Is the amount of time spent on parole reviews appropriate?
- Is it necessary to have pre–release hearings for all offenders?
- Is it feasible to delegate further release authority to the Correctional Service (as is done in other jurisdictions)?
- Is the Board's Decision Making Policy, developed in 1988, still appropriate? Can it be improved?
- Are there changes to the profile of Board membership that might improve its effectiveness; for example, is the current extensive use of part–time members appropriate?

17.71 The Board should review how it carries out its operations to determine whether time and effort are appropriately focussed.

Board's response: *The National Parole Board agrees with this recommendation. We must point out, however, that some areas of concern identified by the authors of the Report cannot be addressed without legislative changes: for example, pre–release hearings for all offenders; delegation of authority to the Correctional Service of Canada; and profile of Board membership, particularly in regard to the extensive use of part–time members. As part of the government's program and agency review exercises, we are reviewing our legislation with a view to making recommendations for changes in these and other areas.*

With respect to some of the other points raised in the report, for example, better focus on high–risk cases, and improvement to the Board's Decision Making Policy, we would like to comment that we are currently in the process of reviewing our decision policies with a view to developing a more efficient tool to assist Board members in their decision–making functions. Furthermore, as indicated in our response to the recommendation in 17.78, a joint NPB/CSC Task Force has been established to ensure that issues of mutual concern to both agencies are addressed and appropriate measures are taken to ensure the most efficient approach to decision making.

Information for Decision Making

17.72 Good decision making requires good information. Many past

investigations of the National Parole Board have indicated that the lack of key information has led to the release of dangerous offenders. However, more information is not necessarily better. It may not result in better decisions.

17.73 We are concerned that Board members are "drowning" in information. National Parole Board files are often voluminous and contain some information that does not necessarily help Board members to decide whether an offender will be a manageable risk in the community. Therefore, while we have identified additional information needs, we believe that any efforts to increase information must be combined with an attempt to structure it in a way that facilitates decision making by Board members.

The National Parole Board continues to need further information on the criminal history of offenders

17.74 The lack of information in offenders' files from police, courts, mental health officials, and young offenders' records has been cited in past reviews, both internal and external, as contributing to the release of dangerous offenders. As part of this audit, we reviewed 89 pre–release decisions made in 1993 and found that all but one file contained either police or court information. Although the presence of this information indicates an improvement from the situation noted in previous reviews, further improvements are needed, particularly with respect to the inclusion of court information. In the Atlantic region, for example, many files did not contain judges' comments. We have been advised that negotiations are in progress to rectify this situation.

17.75 National Parole Board files include a copy of an offender's adult criminal history, but frequently do not contain information of any criminal history as a young offender. In assessing the likelihood that an offender will reoffend, Board members must know not only the circumstances of the current offence but also past criminal behaviour. As well, for certain types of offences, the age at which the first offence occurred is an important indicator of risk. For example, the National Parole Board may be faced with two offenders who have identical adult criminal records. Both may be first–time federal offenders, with extensive provincial adult criminal records involving break and enter. Both are imprisoned for sexual assault. However, one may have a young offender record for break and enter only, while the other may have a young offender record for break and enter as well as convictions for sexual assault. Without knowledge of their records as young offenders, these two offenders could be seen by the Correctional Service and the National Parole Board as posing similar risks to the community.

17.76 Although the National Parole Board and the Correctional Service have the right to use young offender records, they are often unaware that such a record exists. The existence of a record may be discovered because of a reference to it in other documents in the file, or the offender may volunteer that it exists. Even when the existence of a young offender record is known, the record may have been destroyed. The period of retention of young offender records depends on the severity of the offence and whether there has been a subsequent crime–free period of five years.

17.77 The situation is similar for the mental health records of offenders. The National Parole Board can use mental health records for purposes consistent with their original use, for example, in helping

to assess an offender's risk to the community. However, there is no formal mechanism to inform the National Parole Board that these records exist. The issue of sharing such information is currently being pursued by a federal–provincial task force.

17.78 The National Parole Board, with its partners in the criminal justice system, should ensure that relevant information regarding an offender's criminal behaviour, including young offender records and mental health history, is available and included in the National Parole Board files.

Board's response: *Although the National Parole Board agrees that it requires the best, most complete and accurate information to render its decisions, it must be clarified that the responsibility to obtain such information for the National Parole Board falls within the purview of the Correctional Service of Canada (Sections 23, 24 and 25 of the* Correctional and Conditional Release Act*).*

At the present time, there exists no comprehensive tracking system for young offenders' records. We share the concern of the Auditor General that such information is not routinely made available for decision–making purposes.

Notwithstanding the above, problem areas in regard to the quality of the case preparation material are identified and discussed regularly between the National Parole Board and the Correctional Service of Canada through regional and national Interlinkages Committee meetings. In addition, recently a joint NPB/CSC Task Force was established to conduct a comprehensive review of the information required by the National Parole Board for its decision making. A series of recommendations resulted from this first meeting, and action plans were developed with specific time frames for implementation. The members of the Task Force intend to meet twice a year to ensure that problems are identified and solutions sought at the earliest possible moment.

The National Parole Board requires better information from the Correctional Service

17.79 Progress summary reports. While the Board has a great deal of information on file, much of it is repetitive. In addition, the sheer bulk of the files can lead to important information being obscured. To help Board members in reviewing an offender's case, the Correctional Service prepares a progress summary report. Although this report should provide Board members with essential information in a format that permits an efficient, straightforward review, the report is a multipurpose document that does not fully meet the needs of Board members. It often contains non–essential information (for example, an offender's leisure activities) and does not present the information in a format compatible with the needs of Board members. While neither of these flaws would necessarily lead to a bad decision, a better–designed report to meet Board members' needs would help them carry out their reviews.

17.80 Benefit of programs. Board members are required to decide if the programs taken by an offender in prison have addressed his criminal risk and needs. Correctional Service case management officers are required to provide information to Board members concerning programs an offender has taken in prison and the benefits derived from them. Our file review suggests that Board members generally know which programs an offender has taken in the institution. However, they often do not know what (if any) benefit that the offender has received from programs. We

are unable to say whether this lack of information stems from:

- deficiencies in the way the Correctional Service prepares cases;
- deficiencies in how program benefits are evaluated; or
- a lack of tools for determining the benefits of programs taken in a prison setting.

17.81 Because of this lack of information, Board members are often required during a review to make their own assessment of the benefit of programs. We question whether this is a reasonable expectation to place on Board members.

17.82 Community assessments of release plans. The Correctional Service is required to present a release plan to the National Parole Board. The plan must indicate:

- where the offender wants to go when he is released;
- which halfway house is prepared to accept him (if the application is for day parole);
- the proposed programs or treatment that the offender will receive if released; and
- additional conditions required to manage the offender while he is on parole.

17.83 The release plan is prepared by a case management officer stationed in the institution where the offender is imprisoned. Then the plan is forwarded to the parole office in the community where the offender wishes to be released. Parole officers are asked to check the release plan with certain people in the community. These may include police, family, halfway house staff, program providers and victims. The feedback parole officers receive is included as part of a community assessment that is forwarded to the case management officer who originally prepared the plan.

17.84 Parole officers must also provide their own assessment of the suitability of the proposed release plan as part of the community assessment. In addition, if the parole officer believes that the plan was inadequate or the offender was not suitable for release, changes to the plan are suggested. Our review showed that community assessments often do not include this overall assessment. As a result, the National Parole Board is making decisions without appropriate input from those who will manage the offender if parole is granted.

17.85 As these examples illustrate, the Board requires better information from the Correctional Service. However, while the Board depends on the Service for information, it is not powerless. The Board can refuse to conduct certain reviews if it does not have appropriate information. There is never an onus on the Board to parole an offender in the absence of appropriate information.

17.86 The National Parole Board should determine its information needs and arrange to obtain such information from the Correctional Service in a format that facilitates review by Board members.

Board's response: *As indicated in our response to the recommendation in 17.78, the joint NPB/CSC Task Force on the information required by the National Parole Board has been addressing these issues, and appropriate action plans have been developed with specific time frames as to their implementation.*

Chapter 18

Correctional Service of Canada

Supervision of Released Offenders

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Correctional Service of Canada

Supervision of Released Offenders

Assistant Auditor General: David Rattray
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Main Points

18.1 Corrections is costly. In 1992–93, Correctional Service of Canada was responsible for about 22,000 offenders, of which about 9,500 or 40 percent were supervised in the community. The Service spent about 13 percent ($125 million) of its budget on community supervision of offenders. The average annual operating cost of maintaining an offender in the community was $9,500.

18.2 Risk presented by offenders is highest in the community. Virtually all offenders presently in prison will at some time be released to the community. Based on past experience, most will complete their sentence without reoffending. Each year, between 110 and 160 supervised offenders are charged with committing a violent offence. When these offences do occur, they have tragic consequences that can shatter the lives not only of the victims, but their families as well.

18.3 Risk assessment can never be 100 percent accurate. It is not possible to predict with certainty who of the 9,500 offenders supervised in the community will reoffend and, in particular, those who will reoffend violently. The state of the art for predicting human behaviour is imprecise. Consequently, parole supervision requires judgment, training, skill, dedication and perseverance.

18.4 Community supervision of offenders needs more attention by Correctional Service of Canada. Supervision in the community is the final link in the chain that makes up the Canadian justice system. It is the last point at which the system can directly influence or control offenders. It is also the point at which offenders are the least separated from the public and therefore present the greatest risk to society. For that reason, it is crucial that the supervision of offenders in the community be managed well. We found, however, that Service management is not paying enough attention to this area of corrections. Senior management of the Service needs to provide more direction to supervision of offenders in the community.

18.5 Approaches and practices to managing offenders vary widely. In some instances, these variations have produced positive results, which were due in part to the creativity of staff in adapting and refining the Service's approaches to managing offenders. However, in other instances, the various approaches have reflected significant variations in management practices and in resources available among area parole offices. Again, senior management's attention is required to provide necessary discipline and adherence to professional standards and practices.

18.6 Very high–risk offenders on community supervision need greater attention. Ensuring public safety is particularly difficult when supervising very high–risk offenders. Correctional Service of Canada needs to identify these offenders more consistently and accurately; balance parole resources with the risk offenders present; ensure that a commonly defined and understood set of management practices is used consistently across the regions of the country; ensure that sufficient management information is available to implement these practices effectively; and foster an organizational climate that encourages learning from both successful and unsuccessful practices.

Introduction

18.7 The parole officers of the Correctional Service of Canada are responsible for supervising about 9,000 federal offenders who have been released, either by law (after serving two thirds of their sentence) or by the National Parole Board, to serve the last part of their sentence in the community. In addition, they have also undertaken responsibility for supervising about 500 provincial offenders in areas where there are no provincial parole offices.

18.8 In 1992–93 the Service spent $125 million of its $960 million budget to discharge these responsibilities. Although parole supervision accounts for only 13 percent of the total budget, it is an extremely important part of its operations in terms of public safety. Offenders inside penitentiaries are living under tightly controlled conditions. It is when they are in the community that they present the greatest risk to the public. Supervision in the community is the final point at which the Canadian justice system can directly influence or control offenders. Offenders are the least separated from the public and therefore present the greatest risk to society.

18.9 There are about 900 Correctional Service parole employees located in 14 districts across Canada. About two thirds of those employees provide parole supervision, with the remainder responsible for management and administration. In addition, the Service has contracts worth about $40 to 45 million annually with agencies such as the Salvation Army, the John Howard Society and the Elizabeth Fry Society, and with the provinces (through exchange–of–service agreements) for indirect supervision services.

18.10 The mission of Correctional Service is to contribute to public safety. The Service achieves its mission through incarceration of offenders and supervision of released offenders. Correctional Service has followed an active, interventionist approach to offender management. The Service encourages offenders to participate in programs designed to address attitudinal and behavioural factors and thereby reduce the likelihood that they will reoffend. Through this active approach, the Service also hopes to reduce the costs of incarceration, and achieve long–term public safety goals.

18.11 The Service's primary corporate objective is "to enhance the Service's contribution to the protection of society by safely reintegrating a significantly larger number of offenders as law–abiding citizens while reducing the relative use of incarceration as a major correctional intervention." The degree to which offenders have been moved out of its prisons and into the community is shown in Exhibit 18.1. Exhibit 18.2 shows the location of federal offenders (in institutions or in the community). Although data for only 1989 and 1993 are shown, the distribution was fairly stable in the interim.

Supervision in the community is the final point at which the Canadian justice system can directly influence or control offenders. Offenders are the least separated from the public and therefore present the greatest risk to society.

The mission of Correctional Service is to contribute to public safety.

Supervising Offenders Can Be a Very Difficult Job

18.12 Most offenders will be released back into society. Even if not paroled, more than 80 percent will be released, by law, after having served two thirds of their sentence. Of the remainder, those who are serving life sentences or indeterminate sentences, most will also be released after many years of confinement.

18.13 Parole supervisors are required to manage offenders' risk to the community. At the same time, supervisors must try to

Most offenders will be released back into society.

help them reintegrate into the community. Between December 1990 and July 1993, approximately 24,500 offenders were under federal parole supervision. About one half had been convicted of non–violent offences such as break and enter, and theft, about one quarter were convicted of robbery, and the remaining one quarter had convictions for violence against the person, for example, murder, manslaughter, attempted murder, sexual assault and assault (see Exhibit 18.3).

18.14 Further complicating the task of managing offenders is the multitude of serious behavioural and personality problems they often exhibit. More than half of the offenders are illiterate. Many have psychiatric or drug problems and even more have alcohol problems. Many are "prison wise" and are adept at manipulating their correctional supervisors. Offenders are often unable to behave in an acceptable manner when they are on their own and in the community.

18.15 While in the penitentiary, most offenders will participate in programs that are designed to deal with their problems. As a result, ideally, when they enter the community most will pose a lower risk to the general public.

Several Types of Supervised Releases Are Available to Offenders

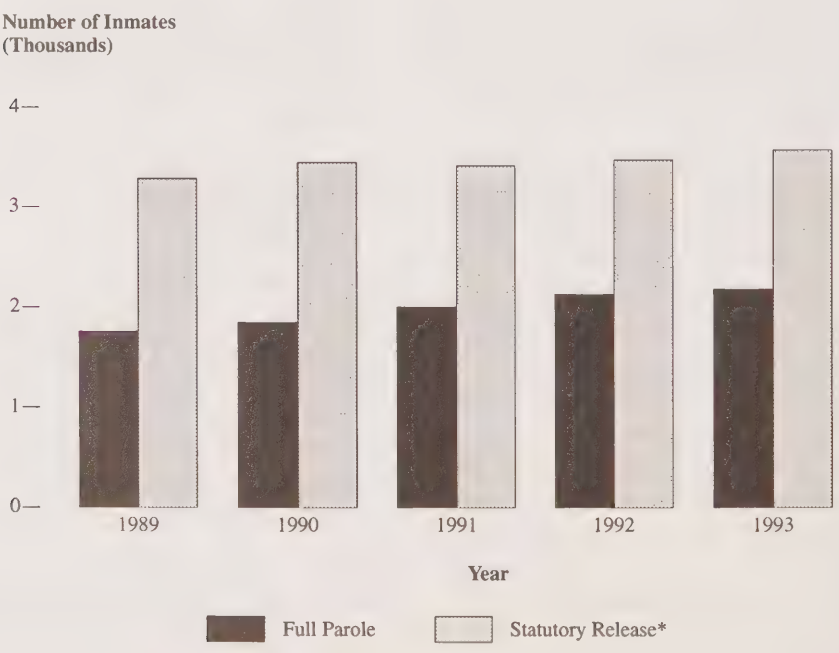
18.16 Very dangerous offenders are detained in prison until the end of their sentence. However, most offenders can be returned to the community under three types of long–term release, at which time they become the responsibility of Correctional Service parole supervision. All these forms of release may be subject to conditions imposed on the offender by the National Parole Board.

- **Day parole** — a form of temporary release (generally six months) under which offenders usually return at night to a community correctional facility (halfway house). Most offenders are eligible for day parole six months before

Exhibit 18.1

Releases on Full Parole and Statutory Release*

Fiscal year ending 31 March



* Referred to as mandatory supervision prior to 1992.

Source: Canadian Centre for Justice Statistics

the date they become eligible for full parole.

- **Full parole** — the full–time release of offenders for the remainder of their sentence. Most offenders are generally eligible for full parole after serving one third of their sentence or seven years, whichever is shorter. There may be exceptions for offenders convicted of certain offences, for example, homicide and other violent offences.

- **Statutory release** — an automatic release, granted by law, to offenders (other than those serving life sentences) who have served two thirds of their sentence without receiving parole. They serve the remainder of their term in the community under the parole supervision of Correctional Service. Current legislation limits the Board's ability to impose a condition restricting where an offender on statutory release may reside.

Supervised Offenders Can Be Suspended

18.17 The National Parole Board determines whether an offender is released on parole; legislation determines whether an offender is released on statutory supervision. Before any release, however, the Service is asked for its assessment of the proposed release plan. Although it cannot reject a release as inappropriate, it does have the authority to suspend the release of any offenders under its supervision if they breach a condition of their release or incur new criminal charges. The Service can also suspend a release when it is satisfied that this is necessary and reasonable in order to prevent a breach of a condition or to protect society.

18.18 One of the key challenges of managing offenders in the community is determining how best to deal with failure. Given the problems that offenders bring with them, it is unrealistic to expect them to reintegrate without making some mistakes. The essence of a parole supervisor's job is knowing when a failure indicates a possible return to criminal behaviour, thus warranting suspension of parole, or when it is just part of making the difficult transition from custody to freedom.

18.19 After suspending an offender, the parole supervisor can cancel the suspension and return him to the community. If the suspension is not cancelled within 30 days, the offender is returned to federal custody, where the National Parole Board reviews the suspension. At the post–suspension review, the Board has the option of returning the offender to the community by cancelling the suspension, or leaving the offender in custody by revoking his release.

Given the problems that offenders bring with them, it is unrealistic to expect them to reintegrate without making some mistakes.

18.20 Exhibit 18.4 shows the number of offenders returned to federal custody under suspension, and the resulting National Parole Board decisions for the five–year period ending 1992–93. What can be seen from this graph is that parole supervisors are actively intervening in the

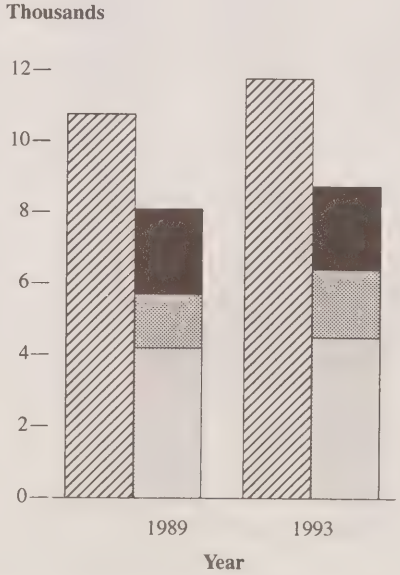


Exhibit 18.2

Distribution of Offenders
Institutional versus Community

Fiscal year ending 31 March

Institutionalized
Statutory Release*
Day Parole
Full Parole

* Referred to as mandatory supervision prior to 1992.

Source: Canadian Centre for Justice Statistics

management of offenders in the community.

Most Supervised Offenders Successfully Complete Their Sentence in the Community

18.21 While under supervision, an offender may be returned to a penitentiary for breaching the conditions of his release or for incurring new criminal charges. Using Correctional Service data, we examined the movement of about 24,500 community supervision cases between December 1990 and July 1993. This included offenders who had been supervised for many years and those who had only just been released. Those data indicated that 12 percent of offenders on full parole returned to a federal penitentiary prior to their warrant expiry by July 1993, whereas 33 percent of statutory releases returned. Another study, perhaps more precise, using a much longer timeframe found recidivism rates of about 25 percent for full parole and 45 percent for statutory releases.

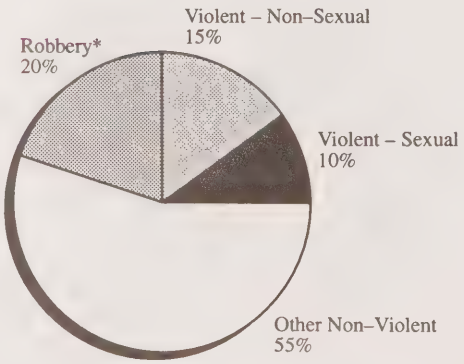
Annually, between 110 and 160 federal offenders are returned to federal penitentiaries because they have been charged with a violent crime against another person.

18.22 Annually, between 110 and 160 federal offenders supervised in the community by Correctional Service are returned to federal penitentiaries because they have been charged with a violent crime against another person. Exhibit 18.5 shows the figures for the last seven years. Correctional Service data do not distinguish accurately the number of offenders who are returned because they have committed a non–violent offence and those who are returned for a parole violation.

Exhibit 18.3

Admission Offences of Offenders under Federal Community Supervision

December 1990 – July 1993



* Robbery is defined as a violent offence by the *Corrections and Conditional Release Act*.

Source: Office of the Auditor General

Correctional Service Operates under Many Constraints

18.23 Several environmental factors affect the management of parole supervision:

- The criminal justice system lacks integration. While the police, courts, penal institutions, National Parole Board and parole supervision may each be managed appropriately on an individual basis, the system as a whole can and does break down. For example, when an offender is moved from the courts to the institutions, to National Parole Board and, finally, to the community, information is not always transferred. Furthermore, all too frequently the "upstream" partners of parole supervision (those involved from the initial charge through the conviction and incarceration and the decision to parole) lack sufficient knowledge of the system's capabilities and limitations to adequately assess an offender's risk to the community.

- The Canadian public's concern with crime, and in particular violent crime, has increased. This has caused Correctional Service to become much more focussed on violent crimes committed by supervised offenders. Preventing supervised offenders from committing further violent offences is an important concern in parole officers' management of offenders. However, negative public response may lead parole supervisors to become overly cautious in managing offenders, which could result in avoidance rather than management of risk.

- It is not possible to predict, with scientific certainty, who will reoffend, or

what circumstances will prevent them from doing so. Parole officers must use their training, judgment and instincts in determining the appropriate supervision regime for managing an offender.

- Both the National Parole Board and Correctional Service face the difficulty of balancing short–term versus long–term risk. The best way to reduce short–term risk may be to keep an offender institutionalized. However, it may be better to release someone sooner under the relatively restrictive environment of day parole and then full parole, rather than wait until the offender is automatically released (into less control) on statutory release after serving two thirds of his sentence.

- Catastrophic failures, and the media attention they generate, shape management's attention and the agenda of the day, thus making it difficult to focus on the design and implementation of long–term solutions.

- The criminal justice system, of which Correctional Service is a part, faces financial restraints like other parts of the public sector. Cutbacks abound and the pressure to "do more with less" is ever–increasing.

Audit Objectives and Scope

18.24 Our audit focussed on Correctional Service's management of high–risk offenders in the community, that is, how the Service identifies and manages the risk presented by offenders who might violently reoffend. While robbery is defined as a violent offence by *the Corrections and Conditional Release Act*, the audit focussed on violent offences against the person, such as murder, assault and sexual assault. Since virtually all offenders under supervision who commit violent offences are male, our analysis excluded female offenders. Therefore, we

It is not possible to predict, with scientific certainty, who will reoffend, or what circumstances will prevent them from doing so.

Exhibit 18.4

National Parole Board Post–Suspension Decisions

Fiscal year ending 31 March



Source: National Parole Board

have used the masculine gender throughout this chapter when referring to offenders.

18.25 The objectives of the audit were to answer the following four questions:

1. How well has the risk to reoffend been identified and communicated to the parole officers?
2. Is the balance between Correctional Service resources and offender risk appropriate?
3. Does Correctional Service have and apply a coherent set of management practices to manage high–risk offenders? Are management controls in place to ensure that those practices are applied consistently — that is, how do managers (and the public) know that offenders have been managed appropriately?
4. How well does Correctional Service learn from its successes and failures?

18.26 In order to answer these questions, we:

- reviewed various Correctional Service and National Parole Board reports, inquests and other reviews of the performance of the Service's parole supervision;
- conducted over 100 interviews of parole supervisors and their managers in headquarters and four of the five regions;
- reviewed existing management information systems, including information on area office workloads;
- conducted a special review of the success of supervised offenders over a 32–month period using Correctional Service administrative data;
- reviewed various descriptions of operating practices and procedures; and
- conducted over 60 case studies of high–risk offenders.

18.27 We did not review the management of offenders under contract supervision; nor did we look at supervision of offenders on unescorted temporary absences or work releases.

Observations and Recommendations

Correctional Service's Management Has Not Paid Enough Attention to Parole Supervision

18.28 The essential job of Correctional Service parole supervision is risk

Exhibit 18.5

Federal Offenders under Community Supervision Charged with Violent Offences

Fiscal year ending 31 March

Type of offence	1988	1989	1990	1991	1992	1993	1994
Murder	25	23	39	20	30	21	16
Attempted Murder	26	21	18	19	24	17	9
Sexual Assault	61	52	63	48	48	43	43
Major Assault	29	37	25	41	39	34	26
Hostage Taking	2	0	3	5	6	1	5
Unlawful Confinement	14	11	11	10	11	19	9
TOTAL	**157**	**144**	**159**	**143**	**158**	**135**	**108**
Rate* per 1,000 supervised offenders	**19**	**18**	**19**	**16**	**18**	**15**	**12**

Source: Correctional Service of Canada

* excludes provincial offenders supervised by Correctional Service

management. The three elements of risk management are:

- the *identification of the nature of the risk to reoffend* and what the offender needs to help him reintegrate successfully in the community;

- the *management of an offender* through the application of a set of tools (for example, intervention, surveillance and follow–up action) that is available and used by a case management officer to manage the risk presented by an offender in the community; and

- the *management direction* and controls in place to provide assurance that such identification and management practices are being implemented consistently and with due regard to economy, efficiency and effectiveness.

18.29 We found that the Service is continuously revising its processes of risk identification and management, and is improving the fundamentals of how it assesses risk. It is changing and improving the way it manages, based on that risk. However, the Service does not focus enough on identifying high–risk offenders throughout the system and ensuring that existing best practices are consistently followed to supervise those offenders. We found examples of good offender management. However, the Service is not consistently taking advantage of local initiatives. In addition, based on our analysis of the variation among parole offices of the time available for supervising offenders, the Service does not allocate its increasingly scarce resources for managing offenders according to the risk they pose. Many of the same problems have been identified in internal and external studies (see Exhibit 18.6).

18.30 These problems reflect the reality that Correctional Service parole supervision needs more direction and attention from management. An institutional "mindset" exists at the Service, whereby key institutional problems are readily addressed, while issues regarding the management of offenders released into the community appear to take second place. Two main factors may have created this mindset: first, most resources and management attention are directed toward the penitentiaries, and second, the National Parole Service was not a responsibility of Correctional Service before 1977. Senior management needs to impose a discipline and focus in order to take advantage of the existing good practices, tools and readily available human resource skills of staff, with a view to reducing the risk to public safety.

The essential job of Correctional Service parole supervision is risk management.

18.31 Correctional Service of Canada should designate a senior official who will report directly to the Commissioner. The individual would be responsible for managing the improvements to practices for supervising offenders in the community.

An institutional "mindset" exists at Correctional Service.

Response: *There is a tendency in any organization with one much larger and one much smaller component for the smaller not to get the attention of senior management it warrants. Hence, for a two–year trial period, a senior advisor, as suggested, will be appointed.*

Identification of High–Risk Offenders Can Be Improved

18.32 To manage an offender in the community, it is necessary to understand the nature and extent of the risk he presents, as well as the circumstances in which this risk can be managed. Only with this understanding can an appropriate course of action be designed so that the public is safeguarded.

18.33 The risk that an offender will reoffend is formally assessed several times

before he is released. The parole officer "inherits" from all of the upstream partners in the criminal justice system an assessment of the risk an offender poses. Part of the parole officer's job is to use this information to manage this risk. However, if earlier assessments have not properly identified the offender's criminal risk and needs, it is more difficult for the parole supervisor to manage them.

High–risk offenders are not identified consistently

18.34 Correctional Service's ability to manage offenders in the community is hampered by inconsistent identification of high–risk offenders. There are many ways in which an offender may be identified as a high–risk offender. For instance, the length of the sentence should reflect the seriousness of the offence; however, given the offender's criminal history, that sentence may not necessarily reflect the degree or nature of the risk the offender presents. As indicated by a recent Statistics Canada study, there is a considerable amount of sentencing variation among jurisdictions in Canada. Another example of inconsistency is the designation of an offender as a "dangerous offender" by the courts. As of December 1992, nearly one half of the dangerous offenders in Canada had been declared in Ontario, with a further one quarter declared in British Columbia. None had been declared in Quebec. As a result, in some regions, greater pressure is exerted on parole supervisors to manage the

Exhibit 18.6

Correctional Service Audits and Investigations

Common Recurring Themes Applicable to Community Supervision

Many of the issues identified in our audit have already been found and reported in Correctional Service audits and investigation reports. The following are some examples taken from a review of these reports:

- "In spite of a well–developed policy framework, however, surprisingly the most common theme . . . relates to staff not following . . . policy statements."
- "CSC has evolved quite rapidly from a highly centralized organization to one in which greater authority is vested in those who actually have to make the daily decisions in the operational units. . . . In some cases, this may result in a fragmented control system with neither effective monitoring of a given program or activity, nor clear statements as to who has responsibility for what."
- "The majority of audit observations . . . have . . . a relationship to staff not doing what they are supposed to be doing or staff not having the knowledge or training required to fully meet the requirements of their positions."
- ". . . many of the deficiencies cited within the audit or investigation reports are of a nature that could be corrected or at least addressed with some sort of supervisory intervention and coaching. This is the role of supervision which appears to be most lacking."
- "Frequently, when asked, staff recognize and admit the fact that they are not following proper procedure or exercising sufficient controls over matters and explain this away with comments to the effect that their workload has increased while resources have either been maintained at existing levels or reduced . . . it is . . . interesting to note the observation in the Case Preparation and Information Sharing audit which concluded that there is no direct relationship between the timeliness of case preparation and case load. In most instances, however, the magnitude of the effect of resource cuts cannot be determined owing in many cases to the lack of work performance standards."
- "Procedures and controls are not always matched with the significance and risk associated with the output they are purported to support."

Source: Correctional Service of Canada

offenders who could have been, but were not, designated as dangerous offenders.

18.35 Another inconsistency results from the varied interpretation of the three conditions for detaining offenders after their statutory release date (see Exhibit 18.7). Without a common interpretation of these conditions, individuals may be released to the community who otherwise would be kept in prison until the end of their sentence.

18.36 Finally, the term "high–risk" has different meanings among Correctional Service parole supervision staff. It can mean either a high likelihood to commit any offence, or a high likelihood to commit a violent offence. Clearly, these divergent meanings of the term diminish its value to the parole officer supervising that high–risk offender.

The term "high–risk" has different meanings.

Risk assessments are sometimes done with incomplete information

18.37 Correctional Service institutions do not always have all relevant, available information when assessing risk. Assessments of an offender may be done prior to receipt of all information that is available from the police and courts. For example, Correctional Service may rely on an offender's version of the offence. Although a later assessment may reflect correct information, erroneous information can remain in the file and may taint future assessments. We noted instances where, despite the availability of correct information, it was not reflected in assessments. As a result, assessments of risk and needs in the community may be based on incorrect information provided by the offender. This constrains parole supervision's ability to effectively manage a high–risk offender.

18.38 As well, Correctional Service information is not always properly transferred to the parole officer from federal penitentiaries. Internal audits found instances in which offenders had been released from prison before information, such as their criminal profile and photograph, had reached the parole office. We found similar examples during our audit.

18.39 Correctional Service has a major effort under way to address difficulties in transferring information and improving access to it. The Offender Management System is a multimillion dollar computer–based system designed to change the way information on offenders is managed. For each offender, it will provide a single electronic file that is accessible to all who need it. It is expected to be fully operational by the end of 1995.

Exhibit 18.7

Inmates Detained after Their Statutory Release Date

In order to keep an inmate in detention after his statutory release date, Correctional Service must conduct a review of the case and demonstrate to the National Parole Board that the following three conditions apply:

1. the offender must have committed a violent offence; and
2. that offence must have caused the death of, or serious harm to (defined as meaning severe physical injury or severe psychological damage), another person; and
3. there are reasonable grounds to believe that the offender will commit another similar kind of offence before his sentence expires.

Or alternatively, for offenders who have committed serious drug offences, there must be reasonable grounds to believe that they are likely to commit a similar kind of offence before their sentence expires.

Source: *Corrections and Conditional Release Act*

Risk assessments could be improved with better diagnostic tools

18.40 Various diagnostic processes are used to identify the risk an offender poses. One instrument, the SIR scale (General Statistical Information on Recidivism) is used to predict the likelihood of reoffence within three years of release. Other instruments, used in the penitentiary, identify needs related to the offender's criminal behaviour. Some are general assessments, intended to identify and prioritize broad needs; others specifically identify individual needs in order to determine appropriate programming. However, to date there is no common set of practices or processes that identifies and tracks changes in an offender's risk and needs.

Correctional Service is working to improve its risk identification.

18.41 Correctional Service is working to improve its risk identification. The Service is introducing a risk identification process that collects information on an offender's risk and needs as soon as he enters the federal penitentiary. Based on that information, it will be possible to measure changes in the risk he presents as he moves through the system. Although the reassessment necessary to measure change is not part of the present risk identification process, the Service has informed us that this capability will be incorporated by the end of 1995.

Risk assessment in the community is combined with needs assessment

18.42 Once in the community, the offender's risk and needs are measured once more. Here, the parole officer, with the offender's input, applies the Community Risk Needs Management Scale. This scale is the key instrument used in identifying and communicating the risk an offender presents in the community. It provides a dynamic risk assessment of an offender's likelihood of reoffending, based in large part on his past behaviour. Then it combines this information with the offender's "needs profile", that is, the information on the factors that have led, in part, to his criminal behaviour. The risk score indicates the extent to which the offender should be controlled, while the needs score gives information on the programming required to deal with the factors associated with his criminal behaviour.

18.43 The parole officer and offender develop a treatment plan based on the Community Risk Needs Management Scale. This plan covers requirements for supervision, reporting, therapy and programs. Correctional Service research shows that this scale can identify offenders who are more likely to have their parole revoked. The scale was designed to make explicit the risk presented by offenders in the community.

Implementing improvements will be difficult

18.44 Despite the initiatives noted, implementing improvements to identification of high–risk offenders will be difficult. There are a large number of initiatives ongoing at any one time, and Correctional Service has an uneven record in implementing changes to management practices. For example, having started development in 1986 of the Offender Management System, the Service has had a series of setbacks in meeting its implementation schedule. As well, implementing recommendations from internal reports has been difficult. For instance, supervision standards still are not fully adhered to despite having been identified as a concern in a number of internal reviews. Nevertheless, it is important that Correctional Service of Canada continue its efforts to ensure that

relevant information is available to facilitate good–quality risk assessment.

18.45 Correctional Service of Canada should develop a clear, comprehensive and commonly understood means for identification of high–risk offenders.

Response: *The risk and needs identification methods used by Correctional Service are generally recognized as "leading edge" in most international corrections. This is not to say that they cannot be improved to better identify those most likely to reoffend violently. It is to say that such improvement will not occur quickly as the research necessary to anchor an effective mechanism must be done first. It is estimated that the development and implementation of such a method will require some time. In the meantime, a number of steps will be taken:*

a) Risk Assessment training will be provided to all Case Management Officers by the end of Fiscal Year 1994–95.

b) A series of "indicators of case deterioration" bulletins, based upon research completed to date and the experience documented in investigation reports, will be developed to assist Case Management Officers in their management of individual cases.

c) The importance of the identification, where possible, of crime cycle patterns will be reinforced as these patterns provide useful indicators of the possible onset of criminal behaviour.

18.46 Correctional Service of Canada should ensure that definitions are used consistently to identify and communicate the risk posed by various offenders.

Response: *Work will commence on developing common understanding and common terminology with respect to particular groupings of offenders and, as these are achieved, they will be shared with all appropriate staff.*

Implementing improvements to identification of high–risk offenders will be difficult.

Parole Supervision Resources Are Not Appropriately Allocated

18.47 We reviewed the activities of area parole offices to determine if, after taking into account the different offender risk profiles, the workload was roughly equal. As it is generally agreed that the key ingredient of a parole officer's job is the time spent supervising offenders, including face–to–face as well as indirect communication (for example, talking to family, employers, etc.), we focussed on the time available for this function.

18.48 Our analysis revealed wide variations among offices in the average time available per offender for direct supervision, after taking into account the time spent by parole officers on such things as travel and reports (see Exhibit 18.8). We did not consider other aspects of a parole officer's job such as managing relationships with voluntary or other interest groups within the community. These variations in supervision time available existed both within and between regions and districts. In short, the resources available to manage a given level of risk vary significantly among parole offices. Accordingly, the risk to the public may be greater in those areas with relatively fewer resources.

Our analysis revealed wide variations among offices in the average time available per offender for direct supervision.

18.49 Since June 1994, a Correctional Service project has been under way to establish workload determinants to develop a staff resourcing model. The results to date from this project support our conclusions. It is expected that the resourcing model will be approved at the end of the calendar year.

This resource imbalance is indicative of the lack of attention that parole supervision has traditionally received.

18.50 The following examples illustrate the wide differences in workload. In one area office, two people were assigned full–time to the high–risk caseload. Each offender was seen twice each week by the two parole officers — once in the office and once in the parolee's home. However, in other area offices, in large part because of the workload, the same type of offender could be seen only once a month, perhaps for as little as 15 minutes in the parole office.

18.51 In theory, the solution to this problem appears to be simple: analyze the workload and reallocate resources. But in reality, the solution is much more difficult. Correctional Service is aware of the problem but numerous factors block its efforts to resolve these imbalances. Those factors include the difficulty of moving staff from one region to another, and the difficulty of predicting the number of offenders who will be under supervision in any parole office at any one time.

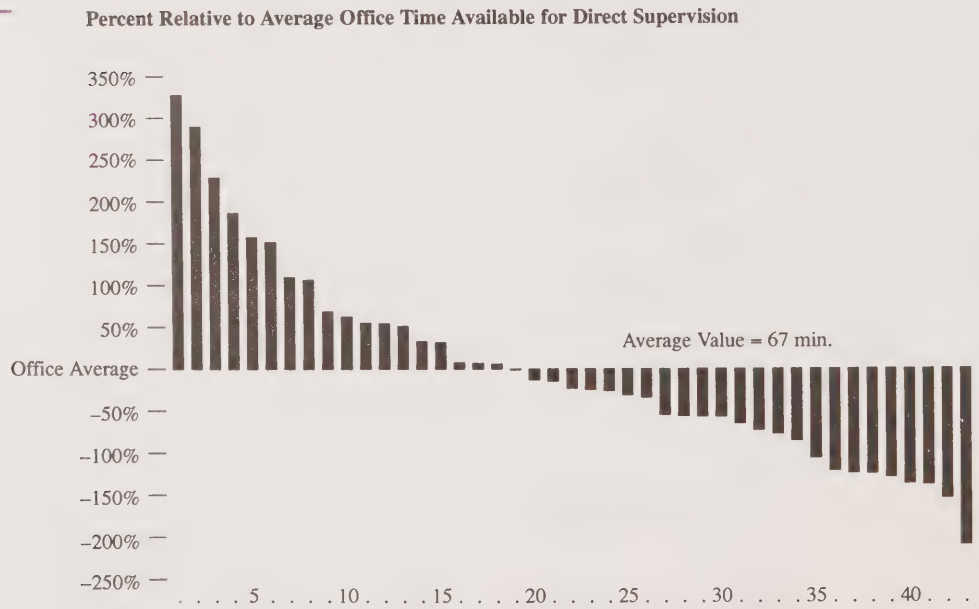
18.52 We believe that this resource imbalance is indicative of the lack of attention that parole supervision has traditionally received. Resolving this problem will require the concerted attention of senior management.

18.53 Correctional Service of Canada should ensure that, to the maximum extent practicable, an appropriate balance is maintained between the resources expended on the supervision of offenders and the risk that they will violently reoffend in the community.

Response: *In correctional circles, it is generally agreed that parole and probation officers should not be expected to handle more than 30 cases, yet many correctional services have caseloads well in excess of 100. Correctional Service of Canada is one of the few services in North America that achieves this goal where the number of supervision cases ranges between 20 and 28, although the figure can vary considerably lower or considerably higher, depending on*

Exhibit 18.8

Variations in Time Available for Supervision Across Parole Offices



Source: Office of the Auditor General

whether the cases are concentrated in one urban area or spread over a larger rural area. It also depends on the mix of cases and whether the cases are direct supervision or indirect through a third party, such as the John Howard Society, and the other responsibilities borne by community correctional staff running community correctional facilities or delivering relapse prevention programs. Correctional Service does, however, acknowledge that improvements in resourcing can be made. It is expected that a new resourcing method will be approved at the end of the calendar year, which will provide guidance for a more effective, correctionally–based distribution of resources.

Ongoing discussions with the National Parole Board are aimed at determining what exactly would make the Board more comfortable regarding supervision arrangements for different types of offenders.

Correctional Service Needs to Apply a Consistent Set of Practices to Managing High–Risk Offenders in the Community

18.54 One would expect Correctional Service to have a set of instruments, practices or approaches that are applied consistently in managing offenders, and that would take into account the need to use different approaches for managing different groups of offenders. Those approaches would recognize that certain types of offenders are more likely to return to federal incarceration. Recidivism rates in the community for different groups of offenders are shown in Exhibit 18.9.

Local parole supervision initiatives need to be properly managed

18.55 For significant, identifiable groups of offenders, we would expect the parole supervisor to have access to a set of

Exhibit 18.9

Comparative Success Rates of Groups of Offenders in the Community under Federal Supervision

December 1990 – July 1993

	Returned Prior to Warrant Expiry % of Total	Did NOT Return Prior to Warrant Expiry % of Total
Comparison # 1 – Type of Release		
Statutory Release	33%	67%
Full Parole	12%	88%
Comparison #2 – Type of Releasing Facility		
Minimum	16%	84%
Medium	30%	70%
Maximum	37%	63%
Comparison #3 – Type of Original Offence		
Violent	18%	82%
Non–Violent	23%	77%
OVERALL*	**22%**	**78%**

* Except for type of releasing facility, percentages are based on a total community offender population of 24,500 for this period of time.

Source: Office of the Auditor General

commonly accepted professional practices for managing offenders. For example, in some area offices every violent offender is required to follow a standardized course of action including programming and supervision requirements. In another district office, it is proposed that all offenders be "cascaded" through a structured set of supervision and programming steps, depending on the type of risk they present to the community. We found no such practices applied consistently across area offices for similar types of offenders. Supervision of high–risk offenders is determined more by the individual preferences of local offices or by the availability of resources.

18.56 Wide differences exist in the way sex offenders under community supervision are treated. For example, in British Columbia, a sex offender is seen three times each week through to the end of his sentence — twice weekly by the parole supervisor in a group setting with other sex offenders and once by a private therapist. Many professionals believe that this type of intervention and supervision is necessary for this group of offenders. In some of the other offices, the management of sex offenders is determined more by available resources than by minimum professional practice requirements.

Supervision of high–risk offenders is determined more by the individual preferences of local offices or by the availability of resources.

18.57 Similarly, many, but not all, regions have team supervision or intensive supervision units designed specifically to manage high–risk offenders. Once assigned to one of those units, an offender can be seen two or three times a week. However, an offender with a similar profile in another area may be seen only once a month. Again, in the absence of national recommended practices, the nature of supervision is based on available resources and local management direction.

18.58 These variations in professional practices can result in inefficiencies in operations. In the absence of nationally established practices, parole officers are not able to just modify good professional practices to suit local operations. Instead, local offices have to develop their own practices to manage certain types of offenders on their local caseload. Those local initiatives to create their own practices may not be the most appropriate use of the already limited resources available in many offices.

Correctional Service lacks information on the performance of its various offices and initiatives

18.59 Part of the difficulty in establishing national practices stems from an inability to determine which local practices are having the best results. While this problem results partly from the difficulty of attributing success or failure to any one practice, it also results from a lack of basic management information on results. For example, Correctional Service has no district–wide or region–wide measures, such as recidivism rates, to determine the success of different practices in managing groups of high–risk offenders. In addition, the Service has no means of reliably assessing trends of such groups over time.

18.60 This variability in professional practices and the lack of management information, combined in some cases with wide differences in workloads, reduces Correctional Service's ability to manage the risk to public safety.

Some initiatives have demonstrably improved performance

18.61 Nevertheless, many good management practices for ensuring high–quality supervision do exist. For example, following a series of four audits of compliance with supervision standards, conducted in 1992 in the Ontario Region,

compliance has increased from an average of 68 percent to over 83 percent.

18.62 Another example is one of the B.C. district offices that selects a small (and different) sample of offenders' cases each month for review by management. Basically, four questions are asked about each case:

- Have the offender's criminogenic needs been appropriately identified?
- Is the treatment plan designed to address each of these criminogenic needs?
- Does the course of supervision reflect realistic monitoring against this plan?
- In the opinion of the manager, is the parole officer "on top of the case"?

18.63 Correctional Service of Canada should establish a list of prescribed supervision practices for different categories of high–risk offenders. Furthermore, the Service should ensure that supervision practices are adhered to, as appropriate, in the day–to–day management of high–risk offenders.

Response: *A project group established in June 1994 is currently examining the quality of individual supervision practice, with a special emphasis on high–risk and special supervision cases. Among the issues being examined are: the quality of the existing supervision standards; the need for professional practice guidelines, including supervision tools and techniques, as a framework for ensuring quality supervision; the effectiveness of such approaches as intensive/team supervision and specialized sex offender supervision and clarification of the techniques contributing to the effectiveness of the approaches; and issues to be researched to enhance the effectiveness of specific interventions with high–risk groups. The initial report from this group is expected in November. Subsequent to the acceptance of the report, policy and practice guidelines will be revised and implemented and the quality of the measures will be monitored.*

As policy and practice standards are agreed to by senior management, they will be implemented in tandem with appropriate monitoring and management of systems. A new sector has been established in National Headquarters – Performance Measurement and Accountability – to strengthen these functions.

Many good management practices for ensuring high–quality supervision do exist.

Correctional Service Needs to Learn from Its Successes and Failures in a Systematic Way

18.64 As noted earlier, the main function of Correctional Service parole officers is risk management. We recognize that some offenders will inevitably reoffend, sometimes with tragic consequences. However, we would expect the Service to have developed an organized way to learn from those situations. We did not find this to be the case.

18.65 Correctional Service's analysis of high–profile incidents on an individual case–by–case basis is reasonably well done; however, no systematic attempt is made to analyze the impact on other parole districts and to communicate the lessons to all parole officers. While some effort is made to generalize beyond individual cases to improve the supervision of offenders, there is only limited effort to determine if improvements have worked, or if underlying problems identified have remained as causal factors in other reoffences.

18.66 During the audit, we observed many instances of what appear to be good management practices or "leading edge" activity (see paragraph 18.62 and Exhibit 18.10). Correctional Service is

Correctional Service is generally recognized as a leader in corrections management.

generally recognized as a leader in corrections management. One of the reasons is the enthusiasm and competencies of the individuals involved. However, we found the Service is not effective at identifying good practices and implementing them nationally where appropriate.

18.67 Correctional Service of Canada should institute procedures to ensure that best practices and lessons learned are identified and communicated to appropriate officials throughout the system.

Response: *The Service has established a method of ensuring discussion of problematic situations by providing synopses of key incident investigations and distributing them to wardens and district directors. It is also beginning to develop some formal case studies for training exercises based on the findings of investigations into significant incidents. In addition, Case Management Management Bulletins are issued to all case managers to highlight measures to correct problems, or those measures that effectively address issues faced by institutions or community offices. Where it is evident that corrective action on a national basis is required, Commissioner's directives will be published.*

It is recognized that there is significant room for improvement in the communication of best practices. The Service is committed to ensuring that the required improvements occur.

Exhibit 18.10

Examples of Good Parole Supervision Practices

Supervision of offenders in Hamilton–Wentworth has been greatly strengthened because of the contributions made by the local police force. A liaison officer sits on the monthly case load supervision meetings where the progress of all the offenders is discussed. Police are regularly informed and consulted about the management of high–risk offenders. This joint supervision of offenders not only reduces the cost of supervision but also can produce greater measures of control, thereby increasing public safety.

The sex offender program in Regina is generally recognized as a very good one. What is particularly noteworthy in this program is the ability of the parole officer to enlist the co–operation of other levels of government (their partners) in providing certain services. For example, provincial health officials provide sex therapy, and provincial correctional officials and local police provide supervision resources.

Source: Office of the Auditor General

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1994

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Chapter 19

Environment Canada

Environmental Partners Fund

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Environment Canada

Environmental Partners Fund

Assistant Auditor General: Robert R. Lalonde
Responsible Auditor: Wayne Cluskey

Main Points

19.1 The Department of the Environment (Environment Canada) does not know in a substantive way whether the Environmental Partners Fund (the Fund) has achieved its intended results. An interim evaluation was carried out in 1993–94. However that evaluation relied mainly on a review of selected projects perceived by management as successful and did not address, in a comprehensive way, all the Fund's objectives.

19.2 Information on the success of the Fund in generating additional contributions appears to be overstated. Information on the environmental benefits of projects is not being reported to management or to Parliament.

19.3 A number of fundamental management deficiencies identified in a 1991 internal audit continue to exist.

Background

Objectives of the Environmental Partners Fund

19.4 The Environmental Partners Fund (the Fund) is a $70 million federal contribution program administered by Environment Canada. The Fund has been allocated $50 million for contributions and $20 million for administration for the years from 1989–90 to 1996–97. It is designed to fund projects that stimulate the development of local initiatives and enhance existing environmental programs. Eligible projects are funded up to 50 percent of project costs, currently to a maximum of $100,000 over two years. In 1991, the Fund became part of the Environmental Citizenship Initiative, a Green Plan initiative.

19.5 Eligible projects should not duplicate or compete with existing services, or displace work normally performed under existing or planned environmental programs at the federal or provincial level, unless they employ new techniques or procedures. Multiple partners in projects are encouraged. Other levels of government may participate but they must designate a non–profit community or environmental group as the "lead partner" accountable for the project.

19.6 The Fund encourages community groups to participate in projects that allow them to use non–cash contributions (also called "in–kind" contributions), such as volunteer labour, which are eligible for matching contributions from the Fund. The government expected that the Fund would generate two or three times the amount of its direct contributions through matching funds from other contributors, and that many projects would continue beyond the period of support.

19.7 The Fund's objectives are:

- to stimulate and support the development and implementation of local action–oriented projects to enhance and preserve Canada's environment;
- to provide matching funds to encourage and enable community organizations and others to develop creative and innovative approaches to local environmental problems;
- to raise the level of public awareness of the need for, and value of, individual and collective action in dealing with both immediate and long–term environmental problems; and
- to promote a conserving society, through collective and individual involvement in local environmental initiatives, thereby contributing to the concept of sustainable development.

19.8 The government intended that the Fund would produce such results as the conservation and restoration of important wetland areas; the restoration of fish and wildlife habitats; improvements in water quality and water conservation; extension of "blue box" recycling programs; extended programs for composting biodegradable wastes; safe disposal of household hazardous wastes; and extension of office, industrial and commercial paper and other waste reduction and recycling programs. Since June 1991, projects that promote non–formal environmental education (educational activities directed at the general public) are also included.

The Fund encourages community groups to participate in projects.

The Nature of Partnerships

19.9 Other federal government departments and other levels of government were significant contributors to projects supported by the Fund. As shown in Exhibit 20.2, contributions from those sources amounted to $37 million, or

Partnerships span traditional jurisdictional boundaries and organizational mandates.

The Fund has approved some 1,200 projects.

just over one fifth of the anticipated total project value of $167 million.

19.10 Partnerships span traditional jurisdictional boundaries and organizational mandates. For example, the Fund has supported such projects as development of nature gardens in local parks and school grounds; production of environment–related plays; construction or restoration of river dams and fish ladders; demonstration of sewage waste water technology; promotion of land stewardship programs; energy conservation in schools and shopping malls; and the care of injured urban wildlife. Some of these projects are the primary responsibilities of other federal departments or levels of government. Therefore, they require extensive co-operation and mutual understanding within and among governments and non–government organizations, while maintaining accountability for the use of public funds.

Organization and Operation of the Fund

19.11 The Fund is delivered by six regional offices and a national office that also co-ordinates its administration. The Department allocates funds to regions and the national office using, with some modification, a formula developed by the Canadian Council of Ministers of the Environment. The process is designed to ensure an equitable allocation of funds based on population, while recognizing the need for a central national fund for projects that cross regional boundaries.

19.12 To 1 December 1993 the Fund had received approximately 3,100 applications, and has approved approximately 1,200 of them. Projects supported by the Fund vary significantly in size and complexity, with the majority of them having a total project value of less than $100,000. Most of the projects are categorized into a specific type of activity, such as recycling or environmental rehabilitation, while other projects include a combination of activities.

Expenditures to Date

19.13 At 1 December 1993, the Department had approved contributions totalling $43 million. These contributions are shown in Exhibit 19.1 by type of eligible activity. At 31 March 1994, the Department estimated that it had spent approximately $35 million in contributions, leaving $8 million committed but not yet spent. It had recorded that approximately $10 million was spent on program administration. This included approximately $5 million for salary costs, $1.5 million for communication and travel and $3.5 million for other administrative costs. Since December 1992, the costs to support other Environmental Citizenship funding activities are absorbed by the Environmental Partners Fund.

Audit Objectives and Scope

19.14 The Environmental Partners Fund typifies the government's new approach to funding environmental initiatives, that is, working with other parties and leveraging funds. Contribution programs or activities may be leveraged significantly and represent a greater investment by Canadians than the actual sum disbursed directly by the programs. Leverage means that the government funding program will support a portion of the costs of a particular undertaking but that other participants must contribute the balance of funds. It implies shared responsibility for common goals.

19.15 The impact of such programs and activities on environmental matters can be

significant. As partnerships become a more prevalent means of government action, the resources provided from all levels of government and non–government sources have the potential to grow in magnitude. Therefore, it is important that appropriate management structures and processes are developed for these new funding mechanisms to ensure adequate accountability for the use of public funds.

19.16 Our audit objectives were to assess:

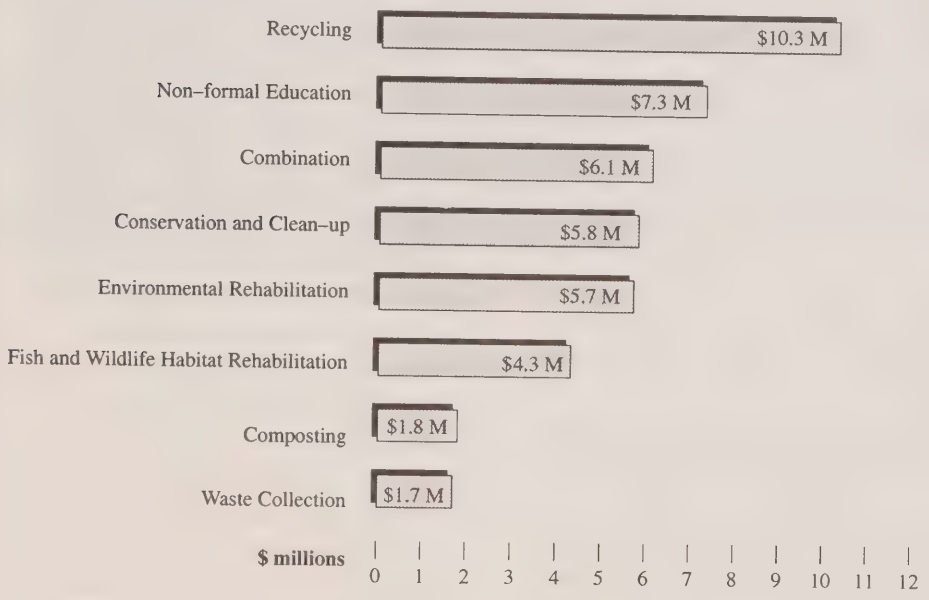
- the existence of adequate performance indicators to determine whether desired results were achieved;
- the adequacy of procedures in place to ensure accountability for compliance with the Fund's terms and conditions;
- the adequacy, relevance, accuracy, and reliability of information on the Fund's operations and results.

19.17 We expected to find that the Department had developed adequate performance indicators and project eligibility criteria. We also expected it to have appropriate procedures to assess project risk, mitigate undesirable effects, and monitor the Fund and project terms and conditions. Finally, we expected that the Department would maintain appropriate systems to provide relevant, accurate and reliable information on the Fund's operations and on the extent to which it had achieved its objectives.

19.18 We visited three regional offices and the national office and we interviewed a number of program staff and members of application review and selection committees. We reviewed 110 projects, or almost 10 percent of the approximately 1,200 projects approved to date. The value of the projects we looked at, including cash and non–cash contributions from all participants, was approximately $57 million out of a total value of $167 million, or just over one third of the total value of approved projects. We selected the projects based on a

Exhibit 19.1

Approved Contributions by Type of Activity



TOTAL CONTRIBUTIONS = $43 M

Source: Departmental Statistics, 1 December 1993

judgmental assessment of risk and also to obtain a cross–section of projects by type of activity. The average value of the projects we selected was $500,000, compared with the average value of projects approved to date of $140,000.

Observations and Recommendations

Effectiveness Issues

A process exists to screen proposed projects

19.19 Departmental staff, intergovernmental application review committees and ministerially appointed selection committees are involved in the project selection and approval process. Staff screen applications for completeness and eligibility. Application review committees, composed of representatives from other federal and provincial government departments and chaired by a Fund staff member, review applications for their environmental effects, financial and technical feasibility and other Fund priorities. The applications are forwarded to the selection committee with their comments and any reservations. Selection committees, composed of community representatives who have an active interest in environmental matters, and chaired by a Fund staff member, review proposals against community priorities and recommend projects for approval by the Minister. Since December 1993, the Minister has delegated authority to approve projects to the regional directors general of Environment Canada.

19.20 Proposed projects are evaluated against such criteria as anticipated environmental benefits, the level of impact on community awareness, and the degree of collective involvement. These criteria clearly relate to the objectives of the Fund.

19.21 Based on the projects we examined, approved projects appear to contribute to creating awareness of, or resolving, environmental issues or else they support the concept of sustainable development. We found that staff were generally very familiar with the projects, and appeared to be monitoring them on an ongoing basis. There appeared to be a genuine effort to obtain comments from technical advisors and we found that attention was given to assessing negative environmental impacts of proposals.

Evaluation of the Fund to date has been incomplete

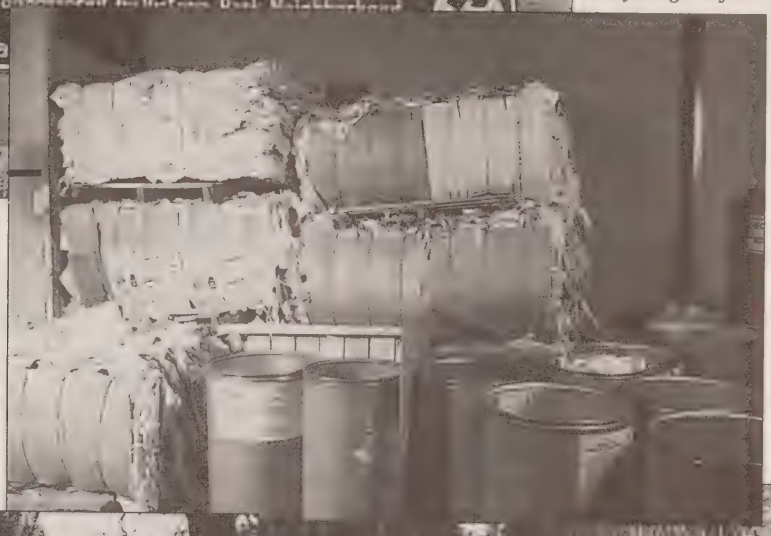
19.22 In 1990, the Department completed a plan for the evaluation of the results achieved by the Fund. The plan identified many issues, performance indicators, and methods to obtain the data necessary to make the assessment. The plan was not implemented and the data have not been accumulated. Instead, in April 1993, an interim evaluation of the Fund was carried out as part of an evaluation of the Environmental Citizenship Initiative, of which the Fund is the major component. In August 1993, the evaluation reported that approximately half the clients interviewed felt that support by the Fund allowed them to turn ideas into concrete action, while others said that Fund support enabled their projects to become more focussed. High rates of community participation and leverage of the Fund's investment were also cited by clients and program staff as major effects of the program.

An interim evaluation did not assess completely or adequately the Fund's impacts, effects and achievements.

19.23 This interim evaluation did not assess completely the Fund's impacts and effects, or its success in meeting its objectives. For example, the evaluation did not measure the effects of the Fund on public awareness, knowledge and



Victoria Park Recycling – Nfld.



Recycling Vanier – Quebec



West River Enhancement Project –PEI



Saltspring Island Small Stream Restoration – B.C.

Source: Departmental Files

behaviour, though these were among the Fund's objectives. The client interviews and case studies that constituted a major source of information for the evaluation represented a small sample of projects selected on the basis of criteria that included being perceived by management as successful and satisfactory. In our opinion, this limits the strength and usefulness of the findings. In addition, some of the findings and conclusions relied primarily on opinion data and were not fully supported by empirical evidence.

Information on the success of the Fund in generating additional contributions is likely overstated.

19.24 Therefore, the Department does not know in any substantive way if the Fund is having the intended impacts. This information is crucial for decision making about the Fund's design, and for accountability to Parliament.

19.25 The Department should carry out a comprehensive evaluation at the end of the program cycle to obtain valid and reliable information on the full range of program impacts, effects and objective achievement issues.

Information on leveraged funds does not reflect actual results

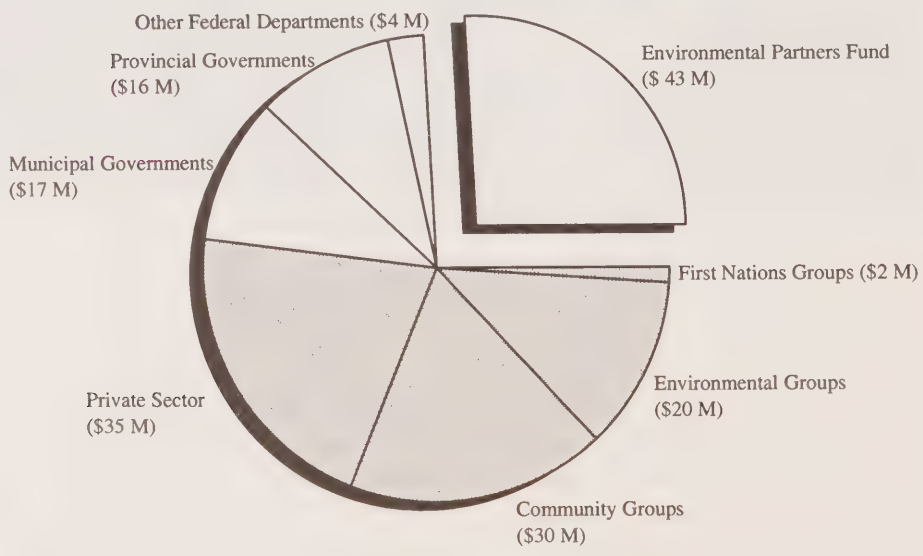
19.26 The Department uses project leverage – the ratio of the Fund's contributions to total contributions by all partners – as one indicator of the Fund's performance. According to departmental records, at 1 December 1993 the projects supported by the Fund were valued at $167 million – $43 million from the Fund and $124 million from others. For every dollar contributed by the Fund, it was estimated that approximately three dollars would be contributed by other sources, including other federal departments. The estimated contributions for approved projects are shown in Exhibit 19.2 by type of partner.

19.27 The data used to support total project activity and leverage statistics were compiled from summaries prepared when the projects were initially approved and funds were committed. However, some projects changed (sometimes significantly) after they were approved and some were cancelled or withdrawn. We have been advised by the Department that, in some cases, revisions were made to the nature of the project to be supported by the Fund.

19.28 An analysis of completed projects, prepared by one region in July 1994, showed that total external resources invested in projects were approximately 20 percent less than had been expected and approved. The Department did not have similar analyses of completed

Exhibit 19.2

Estimated Contributions by Partner on Approved Projects



Source: Departmental Statistics, 1 December 1993

TOTAL ESTIMATED CONTRIBUTIONS = $167 M

projects for other regions. However, if the relationship in this one region is consistent with the experience in other regions, then the $124 million shown as funds to be contributed by other participants (see paragraph 19.26) could be overstated by up to $25 million.

19.29 In addition, we found nine projects in our sample, worth a total of approximately $6 million, that were cancelled before 1 December 1993 but whose dollar amounts were still included in the $124 million.

19.30 Therefore, in our opinion, the actual leverage ratio is likely closer to two dollars for every dollar contributed by the Fund, rather than the three dollars estimated by the Department.

19.31 The continued use of leverage statistics based only on proposed funding at the time of project approval, rather than on actual project financing, means that information on the success of the Fund in generating additional contributions is likely overstated. The failure to provide actual data also makes it impossible to compare actual to estimated costs and funding.

19.32 These leverage statistics measure the success of only one aspect of the Fund: getting the communities and other governments involved. They do not measure whether the projects achieved any worthwhile results in terms of their impact on the environment.

19.33 Finally, we believe that, regardless of the level of government involved, there is only one taxpayer: the Canadian public. In our opinion, for a community–based initiative, a more appropriate measure of leverage is the extent to which non–government sources contribute funds to projects. Exhibit 19.2 shows that, for every dollar of government contributions, approximately one dollar was to be contributed by non–government sources, that is, a leverage of 1 to 1. While this ratio is lower than the Department's calculation, it is still consistent with the Fund objective of matching community efforts.

19.34 The Department should ensure that:

- **leverage statistics are reported accurately;**
- **once actual figures become available, they are reported along with the estimated numbers to allow comparison of actual to anticipated performance.**

Reporting on the impact on the environment needs to be improved

19.35 When the Fund was approved in 1989, the Department said in its submission to Treasury Board that project proposals would include quantitative information on anticipated environmental results. However, until June 1994 the Department did not formally require applicants to indicate how they planned to measure the results of their projects. Before June 1994, in many cases the Department could assess only the general adequacy of the applications. This made it difficult, if not virtually impossible, to estimate systematically the potential for the Fund to achieve its intended environmental results.

19.36 The Department has also approved action–oriented projects that have indirect environmental benefits. They include such projects as soil–acidity testing, promotion of composting or water conservation, and educating landowners on conservation management practices. These activities do not directly clean up or rehabilitate the environment, but may lead to action that can have positive environmental impacts. However, the

Department does not know to what extent this happens.

19.37 With this type of program, there are also intangible benefits that are not easily measured. For example, even if a recycling project failed to collect significant quantities of product or was terminated early, the experience of those individuals participating directly in the projects could potentially influence their environmental behaviour in the long term.

In-kind contributions may have a significant impact on Fund expenditures.

19.38 The Department should ensure that, where possible, appropriate environmental performance indicators are provided and used in assessing both proposed projects and the environmental benefits achieved.

Data on project funding and results are not analyzed or reported

19.39 National information data base is not being used. A data base was developed in 1990 (revised in early 1993) to provide information on project activity, funding, status, and results. However, the national office has no authority to ensure that regions contribute accurate data or use the data base. Two out of six regions did not use the data base because they found that it did not provide them with useful information and it was too difficult to use. The remaining four regions used the national data base only to track applications through the selection process and did not enter data on the results of projects. Also, as the data base cannot aggregate information on project results nationally, any analysis of program activity would have to be done by looking at individual projects. Consequently, the information in the national data base is incomplete and cannot be used effectively in managing the program.

Information in the national data base is incomplete and cannot be used effectively.

19.40 We were informed in mid–August 1994 that the Department has decided to discontinue the use of the data base. Until another system is implemented, there will be a continuing void in management information for decision making and accountability.

19.41 The Department should identify and obtain the information it requires to manage the program effectively and to discharge its accountability to Parliament for results achieved.

19.42 Financial impact of matching in–kind contributions is not measured. The Department places a monetary value on voluntary (in–kind) contributions of labour, materials and equipment by other participants, and includes these "funds" as eligible contributions for matching by the Fund. When seeking approval for the Fund, the Department advised Cabinet that matching in–kind resources with government dollars would not have a significant impact on government expenditures.

19.43 The Department considers the amount of in–kind contributions of labour, in particular, as a positive indication of community participation in environmental issues. However, the Department does not know, in total, the amount of in–kind contributions that have been matched by the Fund, nor does it have any operating guidelines on how they should be managed.

19.44 Analysis of our sample of projects showed that in–kind contributions averaged between one quarter and one third of the resources provided by other participants, including other levels of government. Therefore, in–kind contributions could be as high as $30 million to $40 million dollars if these percentages were applied to all approved projects and could have a significant impact on the size of the cash

contributions made by the Environmental Partners Fund.

19.45 We believe an analysis of in–kind contributions would provide useful information to management on the extent to which they are actually occurring, and would be useful for establishing operating guidelines. As well, it could be used to provide information to parliamentarians on the financial implications to the government of matching volunteered or in–kind resources.

19.46 The Department should analyze the value of non–cash contributions being generated and the size of the expenditure of government funds they have triggered.

Operational Issues

Limits on educational projects were not adequately monitored

19.47 When the program was revised in 1991, Cabinet imposed a limit on non–formal environmental education initiatives of $7 million over the eight–year life of the program. However, the level of such activity was not monitored by either regional or national office staff to ensure that the limit would not be exceeded. At our request, the Department prepared an analysis of the Fund's education activity to 1 September 1993. We updated this analysis to take into account additional approvals to 1 December 1993. We observed that approvals had exceeded the limit by approximately $250,000. As a consequence of its failure to control the level of this activity, the Department had to stop accepting environmental education projects in June 1994, three years before the scheduled end of the program.

Lack of follow–up of internal audit recommendations

19.48 A number of management deficiencies, such as inadequate operating guidelines, lack of national office responsibility to ensure that operating policies and procedures are followed and lack of basic data on program effectiveness, were identified in a 1991 internal audit. Although management indicated that a number of recommendations had been dealt with, we are concerned that the fundamental deficiencies reported in 1991 continue to exist.

Department's response: *The Department agrees with the general observation that it is difficult to ascertain with accuracy the extent to which all program–level intended results are being achieved. The Department has, however, through its internal audit and program evaluation, measured progress in key areas and has been making adjustments to enhance the program's effectiveness. The evaluation demonstrated, and the audit team noted, that approved projects are contributing to both an awareness and the development of solutions to environmental issues. This is in part due to the effectiveness of the rigorous project selection criteria.*

We have taken steps to ensure that adequate information is provided to measure program results and that individual projects are monitored. We recognize weaknesses, as pointed out by the audit team, in linking some of this information to improvements in environmental quality. We are taking action to address this.

Monitoring and follow–up activities need to be improved.

Chapter 20

Environment Canada

Ice Services

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Environment Canada

Ice Services

Assistant Auditor General: Robert R. Lalonde
Responsible Auditor: Wayne Cluskey

Main Points

20.1 The Ice Services Branch of the Atmospheric Environment Service is a recognized world leader in ice information. Based on our review of documentation and on interviews with clients, the operational management of the Ice Services Program appears satisfactory to the extent that it is delivering the prescribed ice information products to clients in accordance with program objectives. Furthermore, the Branch is taking steps to improve the economy and efficiency of its program.

20.2 Action is under way to change the program's main component, ice reconnaissance, from an aircraft–based to a satellite–based activity. This change is occurring at a time when the Atmospheric Environment Service is converting to a client–oriented management approach with a focus on results, and when Treasury Board is requiring that departments reduce budgets and maximize cost recovery.

20.3 The Branch has no formal statement of Canadian Coast Guard operating requirements for ice information. There is no formal feedback mechanism in place for determining the developing needs of the Branch's clients, other than for the Coast Guard. Nor does the Branch have a science and technology policy. All of these are required to guide long–term planning and to establish priorities for individual components of the program. For example, the priority given to data archiving within the overall program has not been clearly established.

20.4 Before the Ice Services Branch can completely achieve the desired results while ensuring economy and efficiency in its operations, it must be able to identify fully, track and analyze evolving demands for ice information and determine cost–recovery expectations over the next decade, based on input from all client groups.

20.5 Any failure in the ice information program due to aircraft, satellite or computer malfunction or communications failure could result in a rerouting or disruption of ship traffic in and out of Canadian ports or, at worst, loss of life and property. In view of Canada's dependence on maritime trade, such a failure could have a considerable economic impact. The Branch must therefore ensure that its contingency plans can be put into effect quickly and successfully.

Introduction

Background

20.6 Ice is a condition of climate that most Canadians live with during a significant part of the year. Its effect on weather and transportation, although most evident in the Arctic, is felt throughout the country.

20.7 The greatest impact of ice is in large lakes, rivers and estuaries — where annual flooding can cause loss of life and property — and in coastal waters, where delay or redirection of ships could add to transportation costs and possibly jeopardize Canadian competitiveness. Ice affects the way we design and operate ships, the way we build and operate breakwaters, docks and bridges and the way we fish and tap offshore oil and gas — in short, it can have significant impacts on the environment and our economy.

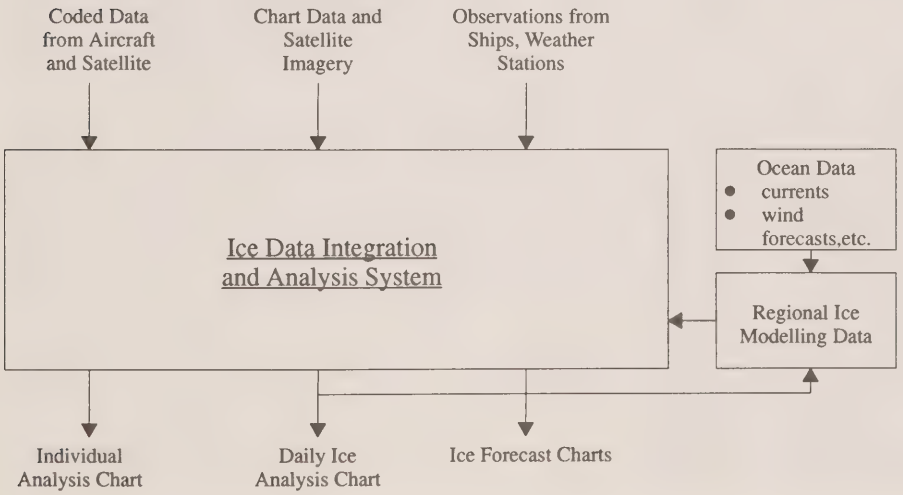
20.8 Canada has almost 120 years of experience in ice research and management. With the longest coastline of any country in the world, most of it icebound for some part of the year, Canada has needed information to minimize the disruptive effects of ice and to forecast its influence on weather and global climate. In 1953, the Ice Reconnaissance Program became part of the Meteorological Branch of the Department of Transport, with responsibility for providing a fully integrated ice information service for Canadian Coast Guard icebreaking activities. By 1971 the Meteorological Branch had become part of the Department of the Environment (or Environment Canada) as the Atmospheric Environment Service. At that time, the Ice Services Branch became responsible for an ice services program with a wide clientele.

20.9 In 1982, the Department of the Environment received Cabinet approval to expand its Ice Services Program to accommodate anticipated needs for ice information into the next century, in support of year–round navigation in the Arctic, the growing offshore exploration for oil and gas, and iceberg surveillance off the east coast. Between 1983 and 1986, the Branch moved from visual observation of ice and manual collection of data to a highly automated radar–based system. During this period, Treasury

Canada has almost 120 years of experience in ice research and management.

Exhibit 20.1

Diagram of Data Flow through the Ice Data Integration and Analysis System



The major operating cost of the Ice Services Branch is $11.5 million for 1,000 hours per year of aircraft time.

Board approved capital expenditures totalling $75 million, which included acquisition of a specially equipped Dash 7 ice reconnaissance aircraft and construction of hangars in the Arctic. The introduction of the Ice Data Integration and Analysis System (Exhibit 20.1), the Iceberg Analysis and Prediction System and the Ice Centre Communications System in the late 1980s dramatically increased the amount of ice information available. Those systems also reduced the time it took to acquire and convey information to clients from one or two days to six to eight hours, and Arctic ice information services became available year–round.

20.10 Overall, the program's capital cost from 1983 to the present has been approximately $82 million. Of this, $3 million was used to establish the Climatological Ice Data Archive System, which began in 1990–91 as the final phase of the program. It was completed in 1993.

The Ice Services Program

Program objectives

20.11 The objectives of the Ice Services Program are to provide ice information analyses, forecasts and warnings to support the efficiency and safety of Canadians involved in such activities as fishing, shipping, and construction and operation of offshore facilities. The program protects the quality of the marine environment by helping to prevent environmental disasters related to ice conditions. It also sends ice information to international data centres to support research on global environmental issues.

Program budget

20.12 The Ice Services Branch operating and capital budget for 1994–95 is $23.3 million and includes 78.5 full–time employee equivalents. The Ice Services Branch recovered $13.9 million in 1993–94 from clients, with



A fishing vessel surrounded by heavy ice in the Gulf of St. Lawrence (see paragraph 20.11).

Courtesy: Ice Services Branch, Department of the Environment

$13.8 million coming from the Coast Guard, its primary client.

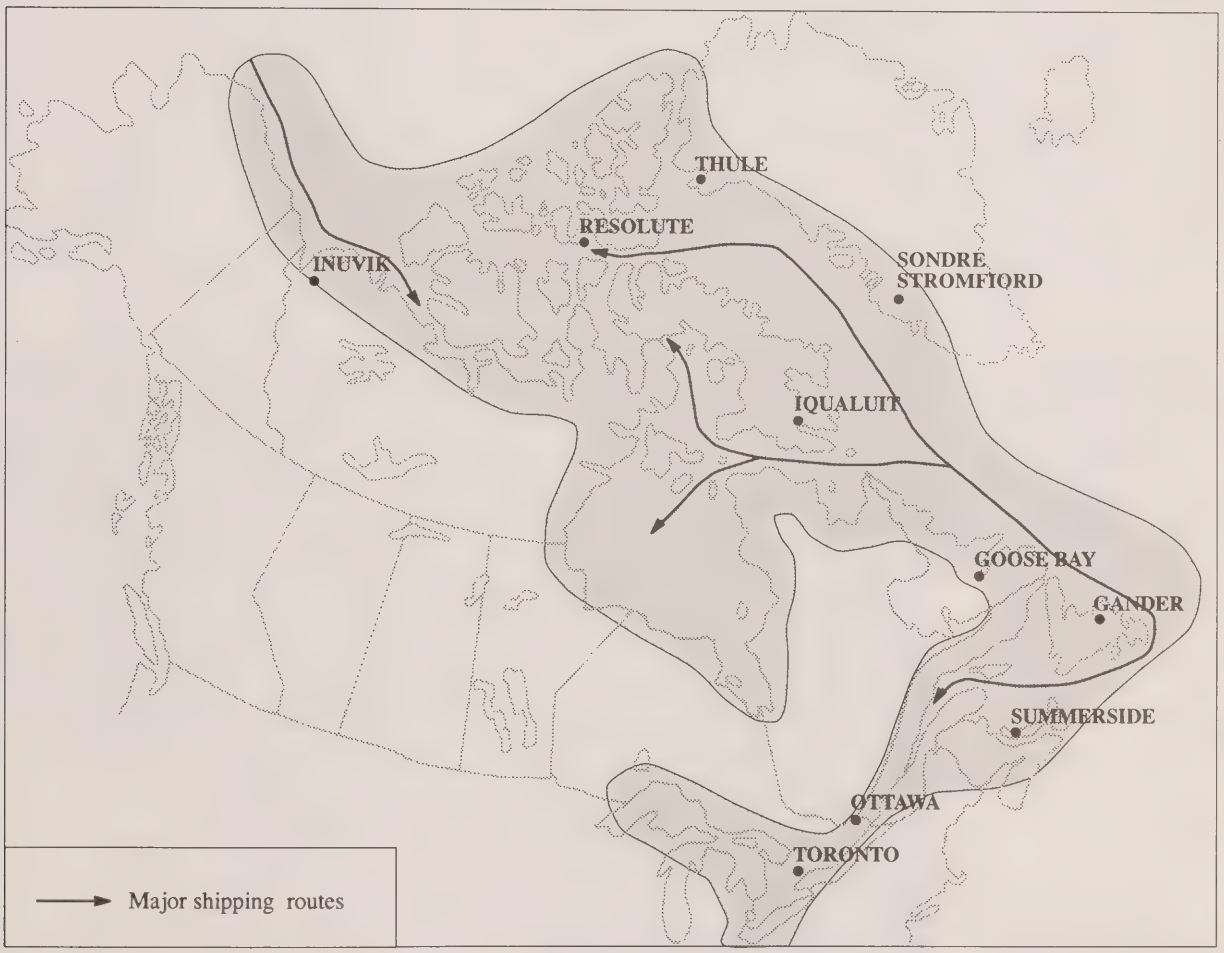
Ice information products

20.13 The major activity of the Ice Services Program involves ice reconnaissance and data analysis. Costs include $11.5 million for 1,000 hours per year of aircraft time gathering ice information, mostly over the Gulf of St. Lawrence – Great Lakes corridor and East Newfoundland waters in winter and in the Canadian Arctic in summer (Exhibit 20.2). With this information, it monitors and predicts the formation, movement, and break–up and melting of ice and icebergs in Canadian waters and those adjacent.

20.14 Dedicated Ice Services aircraft collect ice imagery using radar, supported by imagery from American and European satellites and information based on visual observations from ships and aircraft. The information is received at the Ice Centre

Exhibit 20.2

Ice Services – Areas of Coverage (Seasonal) and Major Shipping Routes



Source: Atmospheric Environment Service, Department of the Environment

in Ottawa, where it is processed into ice charts and other products for transmission to Canadian Coast Guard icebreakers and other users.

20.15 To meet the program's objectives, specific ice information products are provided over a 12–month period. In addition to up to 1,500 daily forecasts, these include 3,000 charts depicting current and forecasted future ice conditions, and responses to an estimated 3,000 inquiries for detailed ice information. These products are used by the Coast Guard and marine industries and contribute to long–term research, by Canadians and others, on global climate and on pollution.

The challenge facing the Ice Services Branch is how to deliver the highest quality of service at the least cost to clients and the taxpayer.

The challenge: to deliver a high–quality service at lowest cost

20.16 The challenge facing the Ice Services Branch is how to deliver the highest quality of service at the least cost to clients and the taxpayer. The Branch is reducing its budget by three to four percent a year over a five–year period ending 1997–98. At the same time, it expects to increase its revenues through better marketing of ice information products and better cost recovery to meet Treasury Board requirements. Some guidance was given to the Branch in the recommendations of the Department's 1991 Ice Services Program evaluation. Those recommendations are being implemented through the Branch's Action Plan, approved in 1992.

Risks of program failure

20.17 There could be serious repercussions from incorrect, incomplete or delayed ice information due to equipment malfunction or breakdown or to communications problems. Icebreakers and commercial shipping would be affected immediately, and life and property could be put at risk if an interruption in the flow of information were prolonged. The loss of ice data would affect the Branch's ability to deliver its program and, in the long term, a break in continuity of data records could have a negative impact on global climate research.

Audit Scope and Approach

20.18 We focussed on the Branch's 1992 action plan, developed in response to the 1991 program evaluation recommendations, and on its strategic planning document. Both contain the Branch's response to pressures for change from departmental senior management (to become more client–driven) and Treasury Board (to increase cost recovery from clients). Although we concentrated on the Ice Centre in Ottawa, we also visited the Canadian Coast Guard's Ice Operations Office in Dartmouth to observe the primary client's use of ice information. We also spent time on two icebreakers to see the practical application of ice information in the field. That also provided an opportunity for us to interview the vessel captains and the Branch's ice specialists at work.

Audit objectives

20.19 The overall objectives of the audit were to determine whether the Ice Services Program was planned and managed with due regard to economy, efficiency and achievement of expected results; and to determine if appropriate action had been taken on the recommendations of the 1991 program evaluation.

Audit criteria

20.20 We expected to find, for each element of the action plan, an objective, performance measures, milestones for

completion and provision for accountability reporting. We expected to find that strategic planning had incorporated information from the action plan implementing the recommendations of the 1991 program evaluation and from other sources, and that the Branch was addressing its new challenges. Specifically, we expected to find that the Branch had identified its clients and their collective needs and had established a consultative mechanism to enable it to meet "evolving client needs" (required under the action plan).

Observations and Recommendations

Need for a Clear Definition of Client Requirements

Service to the Canadian Coast Guard

20.21 The Coast Guard has been the primary client of the Ice Services Branch for over 40 years. Current ice information is required by the Coast Guard primarily for its operations in ice–infested waters, to protect ships from damage and from delays in reaching or leaving port. For example, on our visit in February 1994 to the Coast Guard's Ice Operations Office in Dartmouth, Nova Scotia, we noted that 40 vessels moved on that particular day between the Gulf of St. Lawrence and the Atlantic Ocean, and more than half of them needed some assistance to traverse the shipping lanes.

20.22 The Ice Services Branch transmits information through the Ice Centre in Ottawa to the icebreaker vessels and the Coast Guard's regional Ice Operations offices; they, in turn, advise commercial vessels. The Ice Services Branch supplies an ice service specialist, as needed, to icebreaker captains operating in ice–infested waters — a pool of 12 such specialists was used in 1991–92. The onboard ice specialist interprets, for the captain's use, ice information transmitted from the Ice Centre to the ship, together with information from the ship's own helicopter if it has one, or from a Coast

The Canadian Coast Guard has been the primary client of the Ice Services Branch for over 40 years.



A Coast Guard icebreaker escorting a convoy of ships through easy ice in the Gulf of St. Lawrence (see paragraph 20.21).

Courtesy: Ice Services Branch, Department of the Environment

Guard helicopter operating from another base in support of icebreaking activities. In the opinion of both the ice specialists and the icebreaker captains interviewed during the 1991 program evaluation and our own audit, this partnership between ice specialist and ship's captain is an important one and is unlikely to be replaced by an automated system, at least in the foreseeable future.

To date, the statement of the Coast Guard's operating requirements for ice information has not been formalized.

20.23 Need for a formal statement of Coast Guard's operating requirements for ice information. The 1991 program evaluation recognized the importance of a close relationship between the Ice Services Branch and the Coast Guard. It recommended that the Coast Guard determine its "operating requirements" and take a more active role in technology development, in conjunction with the Ice Services Branch. The Ice Services Branch action plan approved by the Department of the Environment in 1992 did not address those recommendations, leaving them to the Coast Guard alone. The Coast Guard did second a liaison officer to the Ice Services Branch to clarify its ice information requirements. A reference manual was produced, describing the standard procedures used by the Ice Services Branch to provide ice information services and distribute ice information. In September 1993, Annex II — Ice Information Services — to the 1984 Memorandum of Understanding (MOU) between the Atmospheric Environment Service of Environment Canada and Transport Canada was redrafted as part of the proposed renegotiation of the MOU. However, to date, this statement of the Coast Guard's operating requirements for ice information has not been formalized.

Ice reconnaissance is changing from an aircraft–based to a satellite–based activity.

20.24 Given the importance of such information requirements, as reflected in the 1991 program evaluation recommendations, we are concerned that the Ice Services Branch and the Coast Guard are only now proceeding to formalize them in an amended memorandum of understanding. In our opinion, the need for such a statement is long overdue.

20.25 Ability to measure performance. Representatives of the Ice Services Branch and the Coast Guard meet monthly to review the ice information services provided and their application to icebreaking operations. A review of the files and interviews with Branch management and others did not indicate any problems with the ice information services provided by the Branch. However, it is difficult to see how the performance of the Ice Services Branch can be adequately assessed without a formal and current statement of the Coast Guard's ice information requirements against which to measure the delivery of its services.

20.26 Consequences of a delay in formalizing the Coast Guard's operating requirements for ice information. The need for such a formal statement has become even more important, as major technological changes by the Ice Centre are already under way to move ice reconnaissance from an aircraft–based to a satellite–based activity. If, due to operational problems, the new RADARSAT system does not meet Coast Guard needs in obtaining adequate ice data from its three–day coverage of the Gulf or in transmitting the information to icebreakers, gaps in coverage could occur. In spite of supplemental coverage from the Dash 7 aircraft, negative impacts on shipping movements could result, which might endanger the safety of ships, crews and cargoes.

20.27 Counteracting such potential gaps in information would require modifying

the system, for example, by reinstating extensive aircraft–based reconnaissance at additional cost. Alternatively, the Coast Guard might choose to reduce its financial contribution in view of reduced service. Either way, the efficiency and effectiveness of the Ice Services Program could be jeopardized. It is, therefore, in the interests of the Ice Services Branch to complete negotiations as soon as possible.

Service to other clients

20.28 A comprehensive review to determine the needs of the Branch's other clients apart from the Coast Guard is a further prerequisite to developing an efficient program tailored to client requirements. The 1992 action plan and the Atmospheric Environment Service's five–year business plan (1993) obligate the Branch to "consult and involve clients in all aspects of design, development and evaluation of our services."

20.29 Survey of client needs. The Ice Services Branch completed a survey of other clients' needs in August 1993. The overall goal of the survey was "to help determine the value of existing products and to define the potential for new products marketed on a cost–recovery basis." The survey used questionnaires distributed by mail as well as interviews in person or by telephone.

20.30 Because a complete up–to–date list of clients was not available, a sampling frame of 400 clients was constructed from several sources. From this frame, 325 clients were selected to receive the questionnaire. A response rate of 40 percent was achieved.

20.31 The questionnaire was designed to answer two key questions:

- What impact do Ice Services Branch products (existing and possible) have on operational and/or planning decisions made by its clients?
- How can the range of products and services currently offered by the Ice Services Branch be modified, expanded, or changed to reflect the new economic realities of restricted operating budgets, a changing client mix, and new regulatory procedures applied to Arctic shipping?

20.32 When we reviewed the questionnaire against the overall goal (paragraph 20.29) and these key questions, we noted certain gaps. For example, the impact of existing products on the clients' operational planning was only partially addressed by the questionnaire. This meant that some important information was unavailable to the Branch for its own planning purposes. There were no questions concerning cost recovery or the willingness to pay for existing or new products. Questions were asked only on the general value of those ice information products. Furthermore, clients were not asked what they would do if ice information products were not available to them from the Ice Services Branch.

20.33 The Branch adopted an unconventional approach to gathering the data included in the analysis. Questionnaires were completed for respondents who did not return the mailed questionnaire but were interviewed by the consultant and Branch personnel, either in person or by telephone. The questionnaires were completed based on notes of the interviews conducted. In our opinion, such data would have been best analyzed separately from those collected from respondent–completed questionnaires to determine the potential for bias in the overall results and, if necessary, to prevent it.

20.34 Nevertheless, the survey gathered a lot of information that the Ice Services Branch is using to evaluate its ice

information services and to plan for the future. However, there is a need to fill the gaps we have noted and to focus on the clients' "evolving needs" if the Ice Services Program is to provide products tailored to client needs and to maximize cost recovery. This requires regular formal feedback from all client groups rather than infrequent surveys — a moving picture rather than a photograph capturing one particular point in time.

There are still information gaps following completion of the client needs survey.

20.35 Consequences of incomplete information on client needs. Without more information, the Branch has a limited ability to build a dynamic data base of client needs for future planning of both product development and cost recovery. The implementation of the primary recommendation from the 1991 program evaluation — that the Branch become "client driven" rather than "technology driven" — could be put at risk if the development of information products proceeds without a full understanding of client needs. It could result in products for which there is little demand, with subsequent poor cost–recovery opportunities and needless expenditures. Ultimately, such an approach could lead to a loss of clients.

At present, there is no Ice Services Branch science and technology policy to clarify the Branch's responsibilities.

20.36 The Ice Services Branch should build on the results of its recent survey, by establishing a formal feedback mechanism for ongoing client input on such matters as new ice information product development, service standards and cost–recovery strategies.

The Ice Services Branch's Role and Responsibilities

20.37 With the completion of the Expanded Ice Information Service Program in 1993, the Atmospheric Environment Service said that it had "developed and maintained a world class ice information service for Canadians." (*Environmental Science and Technology: An Overview*, Ottawa 1993) However, the 1982 decision to put in place an expanded ice information service that would meet Canada's needs in the 1990s did not foresee the rapid pace of technology development, or the current economic pressures that would influence all government operations. Both factors are now affecting the Ice Services Branch, which is already committed to taking another major technological step in 1995. That is when the ice reconnaissance program will move to a satellite–based operation with the launching of the Canadian Space Agency's RADARSAT. This change is in response to anticipated budget reductions, and senior management guidance will be required to ensure that they can be achieved along with increased revenue generation.

Need for a Science and Technology Policy

20.38 At present, there is no Ice Services Branch science and technology policy to clarify its national and international responsibilities, and to provide direction to managers if reduced appropriations cannot be offset by increased revenue and program adjustments must be made. We expected to find such a policy statement with priorities clearly laid out. For example, should ice reconnaissance be maintained at its current level, at the expense of other program segments such as data archiving? The latter is of paramount importance to the Branch's international clients and is the basis for its worldwide reputation.

20.39 The 1991 evaluation of the Ice Services Program recognized the need for a science and technology policy for the Branch's use. It was an objective of the subsequent 1992 action plan, and was scheduled for completion in December

1993. At the time of our audit this had not been done. The need for a policy was endorsed by the Department's Audit and Evaluation Committee when it approved the action plan in February 1992. Such a policy document defining the Branch's role and responsibilities would have provided guidance for both strategic planning and the client survey activities.

Consequences of a policy vacuum

20.40 While we were pleased to note that service standards are now being developed, we are concerned that this is being done without the benefit of direction from a Branch science and technology policy. Without a science and technology policy, the Ice Services Branch has no guide to help it shape its approach to technological change and respond to the need for any program adjustments. Without such direction, money and time could be inappropriately allocated to a specific program component to the detriment of one client or another. For example, in the case of the Coast Guard, reduced support could impact on Canada's ability to provide the ice information necessary to protect shipping and commercial interests. This could result in a loss of Coast Guard confidence in the program and partial or complete withdrawal from it. The resultant loss of revenue could affect the Branch's ability to carry out its complete program without lowering service standards. In the case of ice data archiving, reduced support could deprive Canadian and international scientists of ice data vital to the understanding of global climate problems.

20.41 The Ice Services Branch should follow up as soon as possible on its action plan commitment to develop a science and technology policy for its own use.

Incomplete Strategic Planning

20.42 The Ice Services Branch Strategic Overview Document (November 1992) lays out its intended approach over a five–year period to meet the requirements of the Atmospheric Environment Services business plan for 1993–94 to 1998–99, entitled: "Our New Way of Doing Business: Building on our Strengths". Its primary aims are to reduce the cost to taxpayers of ice data acquisition and to increase the revenue generated from the provision of ice information and services.

20.43 The overview document outlines strategies as well as actions to be taken, together with milestones, to reduce the money required from the Consolidated Revenue Fund for the Branch's operations from $20.9 million in 1992–93 to $17.9 million in 1997–98. The difference is to be realized through cost recovery from users of the services outside the federal government. The document identifies risks associated with the stated strategies and, in some cases, alternative approaches if cost–recovery plans are not realized.

20.44 The Branch is devoting both time and effort to identifying opportunities for cost recovery. Its progress is evident in the pricing policy and itemized pricing list that have been developed for ice information services. Furthermore, staff are undergoing training to learn "how to transform a government agency into a marketing entity", and a commercialization policy has been prepared. Although the overview document addresses comprehensively this aspect of the new way of doing business, the Branch has not identified its program priorities for available resources if expected revenues from cost recovery do not meet stated targets, and if the balance required to

The Branch has not identified its program priorities for available resources.

maintain the service is not available from the Consolidated Revenue Fund.

Consequences of incomplete strategic planning

20.45 To maintain its international reputation, the Branch needs strategies for dealing with reduced levels of government funding and uncertain levels of revenue; otherwise, it could be faced with a major shortfall in resources and the prospect of either reducing its ice reconnaissance services or sacrificing other components of the program to keep the reconnaissance service at the required level. Either approach could have serious consequences, such as inadequate protection for shipping or loss of historical data to support global warming research.

The Branch predicts an annual minimum saving of $1.5 million.

20.46 The Ice Services Branch should expand its strategic overview document to fully reflect alternative strategies associated with reduced government funding and uncertain levels of revenue generation.

Technology Development

20.47 A major change in the way ice information is collected and processed will occur with the launching of the RADARSAT satellite in 1995. The Ice Services Branch is currently preparing for the conversion from an aircraft–based to a satellite–based system. The Dash 7 aircraft will be retained, however, to provide tactical support to Coast Guard icebreakers and to fill gaps in the RADARSAT strategic coverage (Exhibit 20.3).

A detailed "Contingency Plan for the National Ice Centre" was approved by the Department on 12 April 1994.

20.48 Imagery will be received by the Ice Centre from satellite receiving stations, the material analyzed and the resulting ice information placed on the bulletin board service computer. From this, all clients, including Coast Guard icebreakers and Ice Operations offices, will be able to download information daily into their local computers. Dash 7 flight imagery will be available directly to icebreakers and the Ice Centre in Ottawa. On board icebreakers, ice service specialists will view, compare and analyze the aircraft and satellite data and will advise the captains on ice conditions.

Benefits and costs of the move to RADARSAT

20.49 While the conversion to RADARSAT will require an estimated $2.3 million update to the Ice Centre, the Branch predicts that one of the benefits will be an annual minimum saving of $1.5 million in operating costs when compared to the present aircraft–based operation. The RADARSAT Data Policy identifies ice information as the highest priority for RADARSAT imagery, aside from emergencies. The Branch anticipates that this technology will facilitate user access to ice information and enhance cost–recovery opportunities.

Contingency Plans to Handle Emergencies

20.50 The Ice Services Branch is a high–technology operation, vulnerable to short–term or permanent damage to hardware and software. It is important, therefore, to have adequate contingency arrangements for such emergencies, especially when continuity of service will depend on a satellite outside the control of the Ice Services Branch. This represents a loss of the flexibility provided by aircraft, which can be dispatched anywhere at any time in normal circumstances, as opposed to a satellite with a fixed orbit and schedule. With respect to the Ice Centre, a detailed "Contingency Plan for the National Ice Centre" was approved on 12 April 1994 to protect the "nerve centre" of the operation. It should also be

noted that, under an arrangement with the National Archives of Canada, a backup system for ice data has been established to ensure the protection of the archive should the Ice Centre be damaged or destroyed.

Scope of RADARSAT contingency plan

20.51 The Branch has recognized that problems also could occur with the satellite. It could fail at launch, at deployment or during operation. It has thus prepared a "RADARSAT Contingency Plan", dated 25 March 1994, to respond to such operational emergencies. The plan identifies the major categories of risk, and action to be taken to maintain an acceptable level of service. It relies heavily on the Dash 7 aircraft and on aircraft used by National Defence, Fisheries and Oceans and the private sector.

20.52 Lack of formal agreements to obtain emergency assistance. As stated

One Day

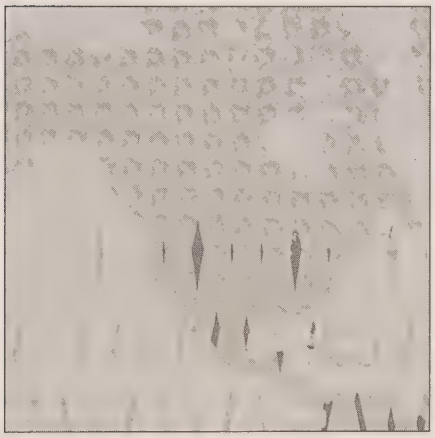


Arctic



North America

Three Days



North America

Exhibit 20.3

RADARSAT Coverage over Canada for One– and Three–Day Periods

Courtesy: RADARSAT International Inc.

above, the contingency plan relies heavily on the use of alternative data sources, such as other resource satellites, and on aircraft currently operated by other government departments. As of 31 May 1994 there were no formal agreements or memoranda of understanding in place to ensure that help from those sources would be forthcoming immediately if emergencies occurred, and if shipping in the Gulf of St. Lawrence and off Newfoundland were put at risk.

The Ice Services Branch has no plans to test emergency arrangements.

20.53 Ice Services Branch should negotiate formal agreements with other government and private sector organizations with roles in the RADARSAT Contingency Plan, whereby priority use of other satellites and aircraft would be obtainable in an emergency.

Viability of contingency plans

20.54 The Ice Services Branch has no plans to test emergency arrangements to see if adequate ice information services can be guaranteed in the event of computer failure at the Ice Centre or satellite malfunction or shutdown. The Coast Guard, in particular, has a major responsibility to safeguard shipping in ice–infested waters and, thus, needs assurance that services would be maintained.

Important sources of ice information are in danger of being lost.

20.55 Ice Services Branch should test its emergency response plan prior to the launch of RADARSAT in 1995.

The Branch's Ice Data Archive

20.56 The Ice Services Branch maintains an ice data archive as part of its mandate to provide ice information. Its capability in this respect has been considerably enhanced by the establishment in 1993 of the Climatological Ice Data Archiving System. While data archiving plays a vital role in global climate research in Canada and abroad and contributes, therefore, to Canada's international standing, the activity has a low profile in the Branch.

Need to update archiving policy

20.57 The present archiving policy, dated October 1986, is still only in draft form. It does not take into account, therefore, the new Climatological Ice Data Archiving System and its impact on the Branch's archiving capabilities and services.

Location and cataloguing of existing ice data

20.58 Informal contacts are maintained by the Ice Services Branch with federal departments that generate ice data — for example, Fisheries and Oceans Canada and the National Research Council — to keep abreast of their data holdings.

20.59 In consultation with industry, academia and private sector consultants, the Ice Services Branch hopes to develop directories listing the sources of available ice data — type, location and contact persons — to provide a more comprehensive service. The work to date has revealed that some important sources of information are in danger of being lost because their value to the original collectors, such as the oil and gas industry, has declined as their projects have been terminated or relocated. These data are valuable to researchers and other users of historical information.

20.60 Importance of uninterrupted ice data collection. Safeguarding Canada's ice data is essential for existing and future Canadian and international climate research, including research on the effects of global warming. The importance of such data is increasing.

20.61 In the past, Canada was covered by a network of meteorological stations — some large, some small one–man, part–time operations — that supplied important ice information. Since the Second World War, however, the departments and agencies responsible for their financial support have closed them one by one, due to changing program priorities and shrinking budgets. Yet those organizations have not notified interested parties, such as the Ice Services Branch, until after the closures. In other cases, monitoring stations have been automated and ice thickness measurements excluded from the data package. These actions have resulted in losses of the valuable continuous data that are so important to climatological and related research, in Canada and abroad.

Consequences of inattention to data archiving

20.62 Without a more comprehensive approach to ice data archiving — comprising the identification, location and protection of data sets, their co-ordination and listing within a recognized national directory or system — Canada is liable to lose valuable ice information. Such a loss would affect, for example, research, engineering design and environmental impact assessment, while reducing our ability to find solutions to global climate problems. This vulnerability applies to both the sophisticated data generated by satellites and the basic ice data gathered routinely at weather stations. If the keeping of ongoing records is terminated, there will be no means to retrieve lost data, and even if such records are later reestablished, their value to researchers will be diminished.

20.63 The responsibilities and priorities of the Ice Services Branch with respect to ice data archiving are unclear. Through membership on the U.S.–Canada Joint Ice Working Group and its standing committees, including that on Data Archives, the Ice Services Branch serves as advisor to the federal government on ice matters, in co-operation with the U.S. government's National Ocean Service. Together, they plan the framework for U.S. and Canadian archiving programs to meet research needs and to ensure their continuing ability to address future problems. Such activities could include the formal recognition of archival material in an international registry. The failure to discharge any of these international responsibilities could have repercussions and damage Canada's image in the global scientific community.

Safeguarding Canada's ice data is essential.

20.64 The Ice Services Branch should:

- **clarify its archiving role by updating and formalizing its internal archiving policy;**
- **develop a national registry listing sources of all available ice data in both the government and the private sectors as a one–stop service to researchers;**
- **seek appropriate input to the Climatological Ice Data Archiving System of data sets that could otherwise be lost, to protect valuable information and avoid future duplication; and**
- **use its international role in archiving, as demonstrated in its representation on the U.S.–Canada Joint Ice Working Group, to conclude formal agreements on data archiving registration with other countries involved in ice data collection and research.**

The Ice Services Branch's responsibilities and priorities for data archiving are unclear.

Overall Conclusions

20.65 The operational management of the Ice Services Program appears to be satisfactory in that it is delivering the prescribed ice information products to

clients in accordance with program objectives. Clients appear satisfied with services they have received, as far as we can ascertain from a review of files and from personal interviews.

20.66 The Branch is taking steps to improve the economy and efficiency of its programs. It is adjusting to budget reductions by pursuing opportunities for cost recovery and other means of generating revenue while maintaining the current level of service. The introduction of RADARSAT is expected to reduce the annual operating costs of ice reconnaissance by a minimum of $1.5 million.

20.67 However, as noted elsewhere in this chapter, there are a number of areas that need to be addressed if the Ice Services Branch is to respond effectively to the challenges facing it in the coming years.

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The audit work reported in this volume was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

Chapter 21

Foreign Affairs and International Trade Canada

Technical Assistance Contributions to Central and Eastern Europe and the Former Soviet Union

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Foreign Affairs and International Trade Canada

Technical Assistance Contributions to Central and Eastern Europe and the Former Soviet Union

Assistant Auditor General: Richard B. Fadden
Responsible Auditor: Vinod Sahgal

Main Points

21.1 Canada's assistance to Central and Eastern Europe and the former Soviet Union has three primary objectives: to support democratic development; to support the transition to market economies; and to increase trade and investment links with the region. The assistance program is based on Canada's national interests and on Canada's assumption of its burden–sharing responsibilities as a member of the G–7 and G–24.

21.2 The Department's technical assistance contributions program for the region has grown rapidly since 1989. In 1993–94, contributions totalled $74 million and cumulative disbursements totalled $145 million.

21.3 The government has conducted evaluations, including a financial management review, to determine whether the program had adequate management systems and practices in place and whether it was meeting its objectives.

21.4 One of the evaluations concluded that the program has quickly delivered a substantial amount of technical assistance to the region; however, in the Department's view, it is not practicable to measure the impact of the assistance of any single donor on democratic development and the transition to market economies in the region.

21.5 Although Canadian companies that participate in the program report significant positive short–term impacts, sustained trade and investment benefits can be assessed only in the long term. An evaluation has concluded that the program requires a more strategic focus to maximize the full potential of the trade and investment opportunities that are available.

21.6 The Department has recently taken steps toward more results–oriented project management, but it is too early to assess their impact. We intend to follow up on the implementation of the various plans developed and initiatives taken by the Department.

21.7 There is a need to improve the quality of the information provided to Parliament on the program's objectives, resources employed and results achieved.

Introduction

21.8 The collapse of the Soviet empire and the emergence of independent states in Central and Eastern Europe and the former Soviet Union (the region) that wish to adopt democratic values and institutions provide a historic opportunity to build a more stable and peaceful world order. These events also present the spectre of regional and global instability if the process fails. Fundamental strategic political and economic interests have motivated Western assistance to the region to support the transition to democracy and market economies. The underlying premise is that competitive free markets, combined with economic stabilization and privatization in a democratic society, will bring prosperity and economic growth. Eventually the region's economies would integrate with the international financial and trade system and this would contribute to increased global stability and a stronger world economy.

21.9 Twenty–seven donor countries provide assistance to the region: the members of the G–24 and three others. The G–24 countries include 12 European Union members, 6 European Free Trade Association members and the United States, Canada, Japan, Australia, New Zealand and Turkey. The Commission of the European Union (as distinct from its members), the World Bank, the International Monetary Fund, the European Bank for Reconstruction and Development and the Organization for Economic Co-operation and Development are the main multilateral donors (Exhibit 21.1). In addition, many state and municipal governments, private sector companies, private foundations and non–governmental organizations are also involved in providing assistance. For example, over 40 federal, state and municipal bodies from Germany alone, each with a range of objectives, are operating in Hungary and the Czech Republic.

Fundamental strategic political and economic interests have motivated Western assistance to the region.

21.10 The multiplicity of governmental, non–governmental and multilateral donors makes effective co-ordination essential but, by the same token, quite difficult. Recognizing this need, donors have put in place various mechanisms to co-ordinate

DONOR COUNTRIES

OECD

European Union
Belgium, Denmark, France, Germany, Greece, Italy, Ireland Luxembourg, Netherlands, Portugal, Spain, U.K.

European Free Trade Association
Austria, Finland, Iceland, Norway, Sweden, Switzerland

Other G–24
Australia, Canada, Japan, New Zealand, Turkey, U.S.

NON–OECD

Taiwan, Saudi Arabia, South Korea

MULTILATERAL ORGANIZATIONS

International Financial Institutions

World Bank, International Monetary Fund, European Bank for Reconstruction and Development

Others

Commission of the European Union (as distinct from its members)

Organization for Economic Co-operation and Development

Exhibit 21.1

Donor Countries and Multilateral Organizations Providing Assistance to Central and Eastern Europe and the Former Soviet Union

Source: Organization for Economic Co-operation and Development/Development Assistance Committee (OECD/DAC)

assistance. In addition, individual donors co-ordinate their efforts with those of other donors in sectors of common interest.

21.11 Figures on the amount of technical assistance disbursements by individual bilateral donors are reported by the Organization for Economic Co-operation and Development/Development Assistance Committee. However, the most recent figures available from this source are for calendar years 1991 and 1992 (Exhibit 21.2). Germany is by far the biggest donor country, while Canada's contribution is relatively small.

The Department manages a program of assistance that complements other Canadian assistance efforts in the region.

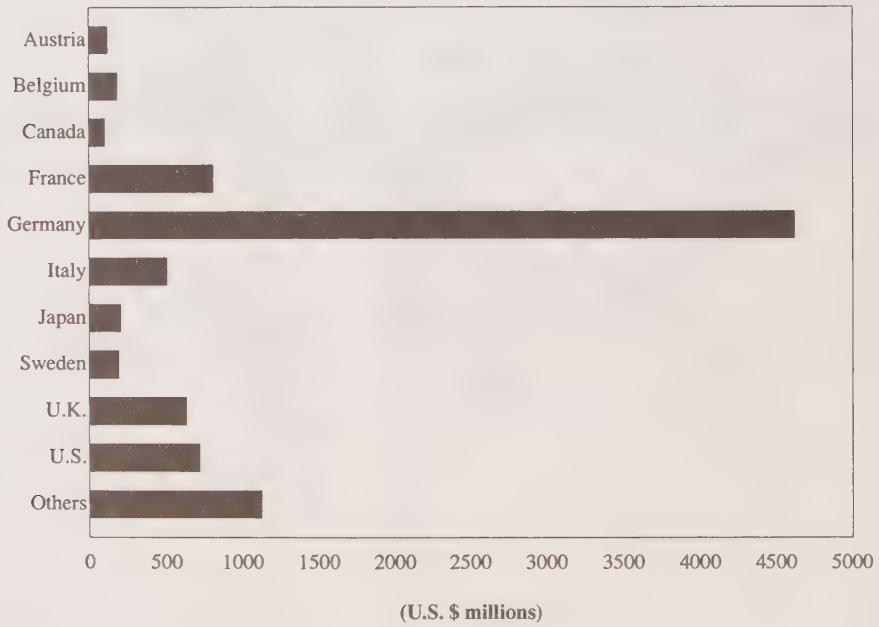
21.12 The last four years have shown that complete political and economic transformation will take considerably longer than first expected by political leaders in donor countries and in countries receiving assistance. Complete transformation will require ongoing donor support, particularly in addressing fundamental macroeconomic problems. Foreign Affairs and International Trade Canada (the Department) believes that this will require a continued active leadership role by the multilateral institutions.

Nature of Assistance

21.13 The Department manages a program of assistance to Central and Eastern Europe and the former Soviet Union that complements other Canadian assistance efforts in the region. These efforts include participation in international policy formulation through membership in the G–7 and in the decision–making bodies of major multilateral institutions, such as the International Financial Institutions, which are active in the region. They provide a wide range of assistance from macroeconomic to project level microeconomic assistance. Canadian assistance efforts also include debt relief. For example, Canada has forgiven a significant part of the interest on export credits extended to Poland by the Export Development Corporation and the Canadian Wheat Board.

Exhibit 21.2

Total Technical Assistance Disbursements by Major Bilateral Donors for Calendar Years 1991 and 1992*



** Figures for calendar year 1993 are not yet available.*

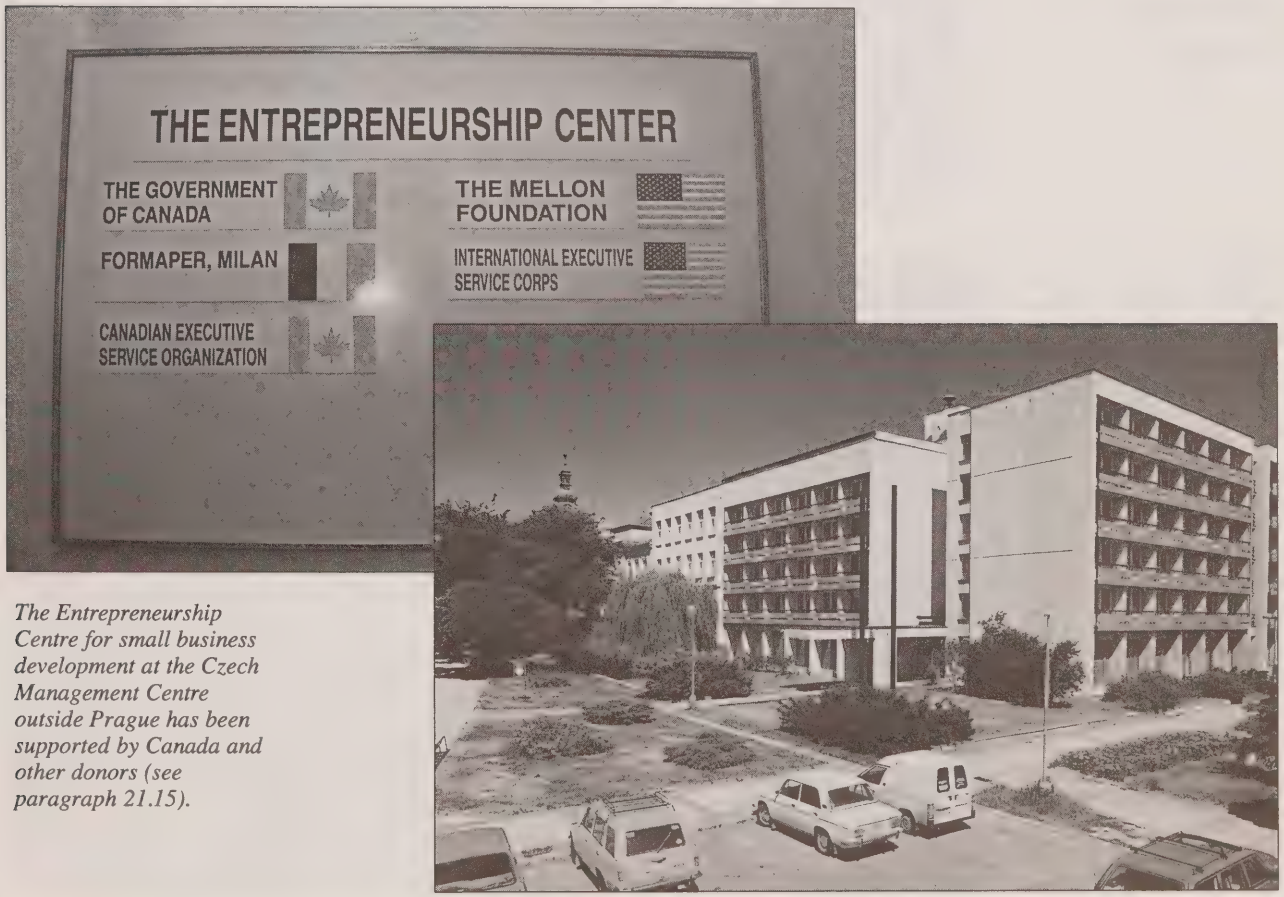
Source: Organization for Economic Co-operation and Development/Development Assistance Committee

21.14 Assistance provided by the Department was initially seen as short–term exceptional funding to support reform efforts in those countries where reform first emerged. For example, an initial Canadian assistance program for Poland and Hungary was launched in 1989. As other countries in the region proceeded to adopt programs of reform, they too became eligible for assistance. Assistance provided by the Department can be divided into three categories.

21.15 Bilateral technical assistance is provided to fund projects in priority sectors in which the Department believes it can make a real contribution to the three primary objectives of the program. Projects are implemented by organizations in Canada in co-operation with partner organizations in recipient countries. These executing agents manage technical co-operation, usually in the form of policy advice, institutional strengthening and human resource development. Included in bilateral technical assistance is the Renaissance Eastern Europe program, a responsive cost–sharing program, which helps Canadian companies develop joint ventures and trade and investment opportunities and enterprise–specific training.

21.16 Multilateral technical assistance contributions are provided to support the programs of multilateral organizations and international financial institutions, including projects promoting good governance and international good conduct.

Bilateral technical assistance is provided to fund projects in priority sectors.



The Entrepreneurship Centre for small business development at the Czech Management Centre outside Prague has been supported by Canada and other donors (see paragraph 21.15).

21.17 Humanitarian assistance is normally provided through United Nations organizations or the Red Cross or Canadian humanitarian organizations, depending on where it can be most useful. For example, food aid has been provided to the most vulnerable groups in countries in the region, particularly the former Yugoslavia, since 1991–92.

21.18 In this chapter, the term "the program" refers to bilateral (including the Renaissance program) and multilateral technical assistance only.

Program Objectives

21.19 The program was set up to serve Canadian foreign policy interests. It is based, first, on Canada's national interests, including the enhancement of global security; the building of a stable and integrated world order based on democratic regimes and market economies compatible with our own; the advancement of Canadian political, economic and trade interests in the region; and enhanced bilateral relations. Second, it is based on Canada's assumption of its burden–sharing responsibilities as a member of the G–7 and G–24.

The program was set up to serve Canadian foreign policy interests.

21.20 Canada is primarily engaged in the region to support the maintenance of global peace and security—that is, to ensure that the opportunity is fully exploited to rebuild a stable world order after the Cold War. A number of countries in the region possess nuclear weapons. Failure to ensure a successful and peaceful transition to democracy and market economies would lead to instability in the European region that would negatively affect Canadian interests and global security. The former Yugoslavia is a case in point.

21.21 The program also promotes Canadian political, economic and trade interests and strengthens bilateral relations. The emerging markets of the region could offer major opportunities for Canadian trade and investment. At the same time, support for the integration of



In Russia, the program has supported projects in oil and gas – one of the priority sectors (see paragraph 21.15).

the region's economies into the global economic system is expected to contribute to a more prosperous world economy and trading system.

21.22 Finally, the strong desire to support and contribute to the region's transformation on the part of the 10 percent of Canadians who trace their family origins to the region is also an important consideration underlying Canada's involvement.

21.23 The Canadian technical assistance program serves Canadian



Canadian assistance has supported democratic reforms in the region. Here is a scene from a conference held in Romania under the Student Democracy Project (see paragraph 21.23).



Canadian assistance has supported local enterprises such as the Community Futures project in Russia (see paragraph 21.23).

The program has three primary objectives: supporting democratic development, supporting the transition to market–based economies and increasing trade and investment links with the region.

foreign policy interests through three primary objectives:

- supporting democratic development;
- supporting the transition to market–based economies; and
- increasing Canadian trade and investment links with the region.

Program Funding, Authority and Organization

21.24 Funding. Initially, the majority of funding was drawn from Treasury Board's Priorities Reserve. However, it soon became clear that the Canadian effort was likely to be long–term and that a more permanent funding source would be required. Since the February 1991 federal Budget, the Department has sought approval from Treasury Board to provide the necessary funding from the reserve of the International Assistance Envelope. The full allocation of the reserve had not been included in the Department's Main Estimates. Remaining amounts from the reserve are included in Supplementary Estimates when international initiatives that require funding are brought forward during the year. The reserve is only a small part of the International Assistance Envelope. The other, much bigger, component is Official Development Assistance; the Canadian International Development Agency (CIDA) is responsible for delivering approximately 80 percent of Official Development Assistance, which is included in the Main Estimates.

The program has evolved in response to commitments made by Canada at various G–7 summits.

21.25 There are several differences between the technical assistance program and CIDA's geographic program: first, the emphasis of the technical assistance program is not on the development of physical and social infrastructures but on helping the people to make the transition to democratic societies and market economies by reapplying their existing knowledge and/or learning new skills; second, it is not based on country–to–country formal bilateral co-operation agreements; and third, most countries in the region served by the program are not eligible for Canadian Official Development Assistance.

21.26 Authority. The broad ambit of the *Department of External Affairs Act, 1980–81–82–83*, gives the Minister of Foreign Affairs the authority to deliver the technical assistance program. The Department has not sought specific enabling legislation for the program itself. Rather, its policy framework and financial resources have been provided through a series of Cabinet and Treasury Board decisions. The program has evolved in response to commitments made by Canada at various G–7 summits between 1989 and 1993, for example, commitments to technical assistance for Poland and Hungary at the 1989 Paris summit (in concert with other G–7 members) and for the Soviet Union at the 1991 London summit.

21.27 Terms and conditions approved by Treasury Board set out the authorities framework within which the program operates. Delegation of project approval authority is decided within the Department. Until February 1994, senior management had the delegated authority to approve projects of up to $5 million, although officials point out that they sought "ministerial approval on all projects of potential political and economic significance and on those worth $5 million or more." Currently, ministerial approval is required for all projects above $100,000.

21.28 Organization. In 1989, a task force was established to manage the program. Then, in July 1993, following Treasury Board approval of ongoing

Canadian assistance to the region, the Department created a permanent Bureau of Assistance for Central and Eastern Europe to replace the task force. The new Bureau is part of the Department's Europe Branch, which is responsible for managing Canada's relations with Western and Eastern Europe and for the pursuit of Canadian interests there.

21.29 As the program has grown, so has the number of persons involved in its management and delivery. For example, headquarters staff increased from 5 persons in 1989 to 67 permanent positions by 31 March 1994. In addition, 10 Canada–based staff and 25 locally engaged program and support staff at missions abroad are currently involved in delivering the technical assistance program. Operating expenditures reported by the Department were $2.0 million in 1992–93 and $7.2 million in 1993–94. This is expected to increase in 1994–95, partly because more Canada–based and locally engaged technical assistance staff have been posted in several missions abroad.

Program Scope and Expenditures

21.30 **Eligible countries.** The program has grown rapidly in scope from two eligible countries in 1989 to 26 countries in 1994: eight program countries and six non–program countries in Central and Eastern Europe and three program countries and nine non–program countries in the former Soviet Union (Exhibit 21.3).

21.31 Program countries have specific budget allocations, are eligible for all forms of assistance and benefit from technical assistance projects designed to respond to their needs. Non–program countries do not have specific budget allocations; however, they are eligible for occasional responsive projects of technical assistance and can benefit from regional, multilateral and humanitarian assistance and the Renaissance Eastern Europe program. Ministers determine countries' eligibility for assistance based on Canadian economic, political and security interests in order to maximize the impact of limited resources in key countries. Budget allocations are based on multi–year commitments made by the government, the needs of the country, its commitment to reform, and Canadian interests and strengths.

The program has grown rapidly in scope from two eligible countries in 1989 to 26 countries in 1994.

21.32 **Disbursements.** The growth in annual disbursements has been dramatic (Exhibit 21.4). Starting at less than $2 million in 1989–90, technical assistance contributions reached $74 million annually in 1993–94. Although total assistance in each of the last two fiscal years has averaged about $100 million, the share of humanitarian assistance has declined while that of technical assistance has increased. The Department expects this trend to continue in 1994–95. However, it points out that since the program budget for 1994–95 had at the time of the audit, not been finalized by ministers, it is not in a position to speculate on program allocations for 1994–95.

The growth in annual technical assistance disbursements has been dramatic: from $ 2 million in 1989–90 to $ 74 million in 1993–94.

21.33 On a cumulative basis, by the end of 1993–94, Canadian technical assistance contributions totalled $145 million: about $126 million in bilateral technical assistance (including roughly $16 million for the Renaissance program) and nearly $19 million in technical assistance contributions to multilateral agencies for their initiatives and for projects in nuclear safety and peace and democracy. The Department also disbursed close to $95 million in humanitarian assistance in the same period (Exhibit 21.5).

Over 700 bilateral projects involving more than 400 executing agents have been funded since the program's inception.

21.34 **Number of projects.** The Department estimates that over

700 bilateral projects involving more than 400 executing agents have been funded since the program's inception. Five countries (Czech Republic, Hungary, Poland, Russia and Ukraine) have received the bulk of Canadian technical assistance. Exhibit 21.5 shows the breakdown of bilateral technical assistance disbursements for 1989–90 to 1993–94 by sector (more than 50 percent has gone to projects in private sector development and democratization); Exhibit 21.6 shows the breakdown of bilateral technical assistance commitments for 1993–94 by type of executing agent;

Exhibit 21.3

Countries in Central and Eastern Europe and the Former Soviet Union Eligible for Canadian Bilateral Assistance

Central and Eastern Europe Program Countries

Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia

Central and Eastern Europe Non–Program Countries

Albania, Bulgaria, Bosnia–Herzegovina, Croatia, Slovenia and Former Yugoslav Republic of Macadonia

Former Soviet Union Program Countries

Kazakhstan, Russia, Ukraine,

Former Soviet Union Non–Program Countries

Armenia, Azerbaijan, Belarus, Georgia, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, Uzbekistan



Source: Foreign Affairs and International Trade Canada

and Exhibit 21.7 shows their breakdown for 1993–94 by project size.

Audit Objectives, Scope and Approach

21.35 We conducted this audit recognizing that the program had had to be organized quickly to respond to rapidly changing events. Although the program is still less than five years old, it has represented one of the fastest growing expenditure areas in the Department in recent years.

21.36 Another consideration in our decision to conduct this audit was the concern expressed by U.S. General Accounting Office reports and, more recently, by a U.S. Congressional report about the U.S. AID program for Eastern Europe and the former Soviet Union. The rationale and objectives of the U.S. program are quite similar to those of technical assistance programs funded by Canada and other donor countries. Problem areas cited in the U.S. AID program include project management, donor co-ordination and effectiveness in meeting program objectives.

21.37 **Audit objectives.** The goal of this audit was to provide objective information that would help Parliament scrutinize the Department's use of resources and its management of expected results. In addition, we wanted to highlight areas where improvements are possible in both program and project management.

21.38 We expected to find that the Department's management of this program would give special emphasis to:

- measuring and reporting on the effectiveness of the program in meeting the objectives set for it by the government and on the results of the projects it funds; and
- obtaining independent assurance that moneys spent by the Department's executing agents on its behalf were spent for the purposes intended by Parliament and were fully accounted for.

The goal of this audit was to provide objective information to help Parliament scrutinize the use of resources and the management of expected results.

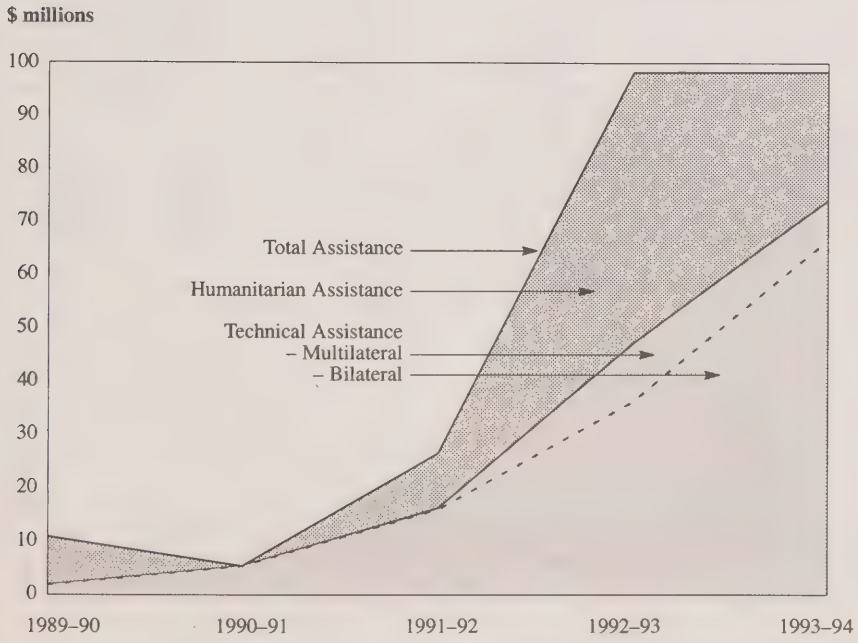


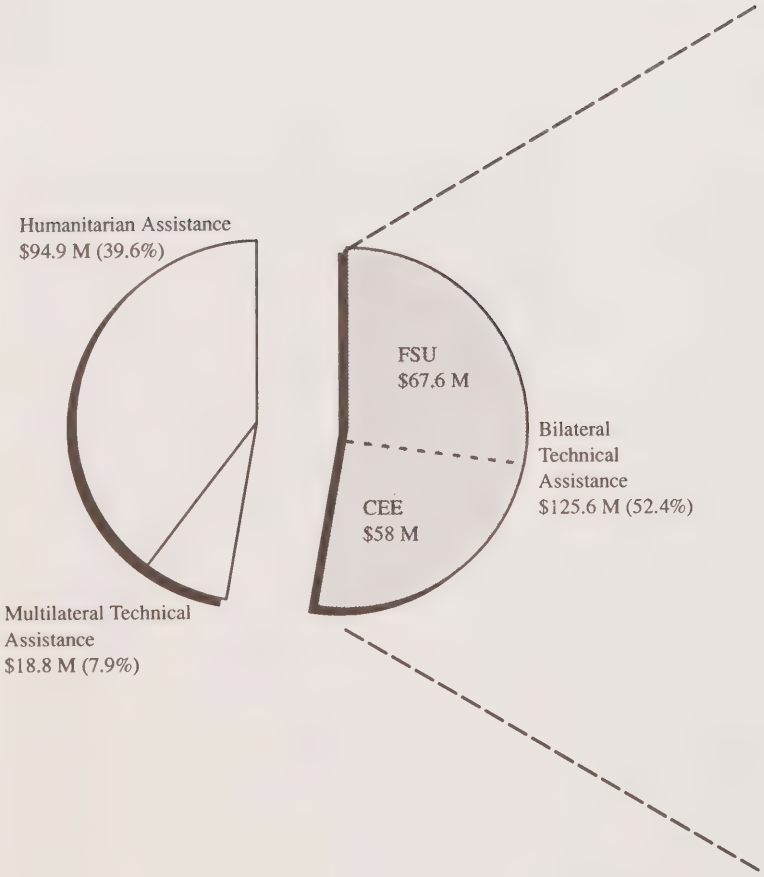
Exhibit 21.4

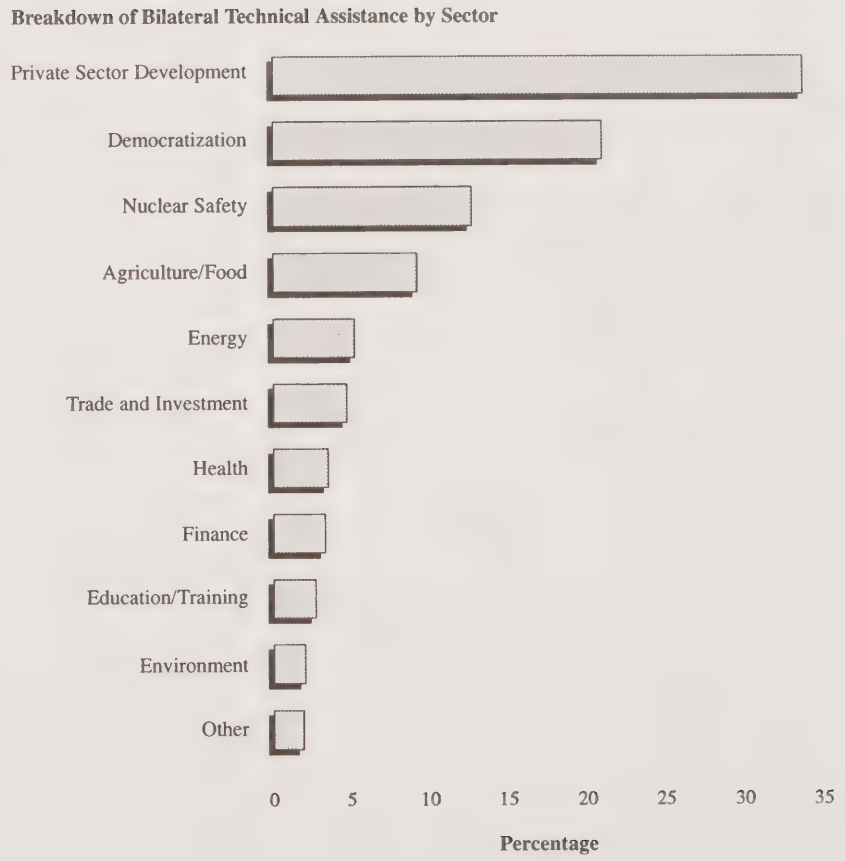
Growth in Canadian Technical and Humanitarian Assistance Disbursements to Central and Eastern Europe and the Former Soviet Union from 1989–90 to 1993–94

Source: Foreign Affairs and International Trade Canada

Exhibit 21.5

Breakdown of Canadian Assistance Disbursements to Central and Eastern Europe (CEE) and the Former Soviet Union (FSU) from 1989–90 to 1993–94





Source: Foreign Affairs and International Trade Canada

21.39 Scope. The scope of the audit was the $145 million in technical assistance contributions managed by the Department between late 1989 and 31 March 1994. The $95 million disbursed by the Department in humanitarian assistance in the same period was excluded from the audit.

21.40 Approach. The audit was essentially a headquarters audit based on a review of program and project documentation. We consulted with program staff and other departmental officials, departmental consultants and academic experts. We also briefly visited the Canadian missions in Budapest and Prague to interview program officers, the heads of mission, a selected number of executing agents in the field and a number of beneficiaries of Canadian technical assistance.

21.41 In addition, we referred to one program evaluation initiated by the government, and one program evaluation and one financial management review initiated by the Department. We did not examine the methodology used in the evaluations and the financial review, and we offer no opinion on their quality. However, we do comment on the terms of reference and we state their conclusions. The Department has informed us that it concurs with the conclusions of the studies.

Audit Observations

Program Evaluation

The government has evaluated its technical assistance program on a timely basis

21.42 The program was announced in October 1989; necessary financial resources were approved by Treasury Board in November 1989; and the program became operational in early 1990. Within two and a half years of commencing operations, the Department contracted outside consultants to evaluate the program and its financial management and control procedures. We think this action was timely and commendable. It shows concern for value for money.

21.43 Financial management review. In October 1992, the Department commissioned a review to assess the program's financial management and control structure to plan, account for and report on the program. The report in December 1992 noted that one indicator

The government has evaluated the program on a timely basis. Studies were initiated within two and a half years of commencing operations to evaluate the program and its financial management and control procedures.

Type of Executing Agent	Number of Projects	Percentage of Total Number of Projects	Amount Committed ($)	Percentage of Total Amount Committed
Academic Institutions	36	10.9	28,793,844	28.4
Business Sector & Associations	187	56.8	25,249,496	24.9
Government – federal, provincial and municipal	75	22.8	32,752,048	32.3
Non–Governmental Organizations	16	4.9	7,977,457	7.9
Others	15	4.6	6,631,920	6.5
Total	**329**	**100.0**	**101,395,765**	**100.0**

Note: This list is based on approved project commitments, not project disbursements; the total is therefore larger than the amount expended by the program in the fiscal year.

Exhibit 21.6

Canadian Commitments by Type of Executing Agent

Technical Assistance for Fiscal Year 1993–94

Source: Foreign Affairs and International Trade Canada

of the program's success was its ability "to process the approval of proposals quickly." The report also pointed out that there was a need "to ensure an appropriate balance between the organization's flexibility and ability to react quickly to the needs of the Central and Eastern European countries while improving the financial control framework." Specifically, the report pointed to weaknesses in project management, such as lack of selection criteria, ongoing monitoring, periodic evaluation and reporting, and financial controls to ensure that funds were spent according to program objectives.

21.44 Evaluation of the technical assistance program. In response to a Treasury Board requirement, a consultant was asked in June 1992 to conduct "an evaluation study of the technical assistance program." (The Renaissance program was not included in this evaluation.) Its task was to determine whether the program was successfully contributing to achieving Canada's foreign policy objectives in the region, and how well the task force managing the program was balancing the need to plan and consult partners with the need to deliver large amounts of technical assistance in short order.

21.45 The evaluation, completed in February 1993, concluded that "the activities of the Task Force are contributing to and supporting Canada's foreign policy objectives" as a result of getting technical assistance into the region quickly, through a large number of projects in activity areas linked to the mandate given it by Cabinet. In addition, the evaluation reported that, based on its detailed analysis of randomly selected projects and on a survey of respondents who had received moneys from the program, "significant impacts had already been realized." The evaluation also pointed out that "the Task Force has balanced the need to deliver the program with the need to consult partners" and "the general approach taken to implement and deliver the program is sound and effective."

Exhibit 21.7

Canadian Commitments by Project Size

Technical Assistance for Fiscal Year 1993–94

Project Size ($)	Number of Projects	Percentage of Total Number of Projects	Total Value of Projects ($)	Percentage of Total Value of Projects
1–99,999	211	64.1	7,851,131	7.7
100,000–249,999	43	13.1	6,940,613	6.8
250,000–499,999	38	11.6	15,073,851	14.9
500,000–999,999	17	5.2	12,975,785	12.8
1,000,000–9,999,999	18	5.5	38,554,385	38.0
10,000,000 +	2	0.6	20,000,000	19.7
Total	**329**	**100.0**	**101,395,765**	**100.0**

Source: Foreign Affairs and International Trade Canada

Note: This list is based on approved project commitments, not project disbursements; the total is therefore larger than the amount expended by the program in the fiscal year.

21.46 The evaluation recommended changes in program delivery to improve project management, such as better monitoring, evaluation, auditing and performance measurement. In addition, the evaluation recommended that the program's ability to maximize benefits from trade and investment opportunities could be enhanced by adopting a more strategic focus.

21.47 Evaluation of the Renaissance program. The effectiveness of the Renaissance Eastern Europe program was evaluated in 1993 in terms of its relevance, the appropriateness of its objectives, its impact and how it could be further improved. Completed in December 1993, the evaluation concluded that "overall there continues to be a strong rationale for the program. It is achieving its objective and significant commercial impacts are being realized as a direct result of the funding being provided. In general, the program is being delivered effectively and efficiently." However, the report pointed out administrative shortcomings related to project monitoring and auditing. In addition, it stated that "information on doing business in the region, which is often gathered from companies, is not being dispersed to other Canadian companies or other government staff."

The Department is implementing recommendations made by the studies, but it is too early to assess the full impact of steps taken

21.48 The program evaluations and the financial management review made many recommendations to improve project management and program financial management. The Department has accepted these recommendations and has taken steps to implement them. Specifically:

- A guideline for preparing country program strategies was introduced in November 1993.
- A guideline for preparing project proposals, which outlines the kind and extent of information required before a new project proposal will be considered, is currently being revised.
- A new project approval document was introduced in early 1993. This document is used by the Project Review Committee in its review of proposed projects and in formulating its recommendations.
- Provision for project monitoring and evaluation in the project approval document was introduced in June 1993.
- A program evaluation function is being established in the Bureau, and revised terms of reference for evaluation contracts have been developed by the Department's Office of the Inspector General (April 1994).
- Technical assistance sections in seven Canadian missions in the region have been created, and their staffing—with 10 Canada–based and additional locally engaged staff—is expected to be completed by the end of September 1994.
- Contribution agreements now provide for a complete management framework including goals and objectives, and executing agents have been required to provide narrative and financial information to facilitate subsequent monitoring and evaluation.
- Ten financial audits of projects completed between 1989 and 1992 were initiated between December 1992 and December 1993.
- An annual project audit plan was introduced in April 1994.

21.49 Some of these actions were started fairly recently and some have not yet been fully implemented. In particular,

The Department has taken steps to improve project management and program financial management but it is too early to assess the full impact of the steps taken.

10 projects in Hungary and the Czech Republic that we examined in the field had not been affected by most of these recent actions. Therefore, it is too early for us to assess their impact at this time. We propose to conduct an assessment of these actions through examination of more recent projects in our follow–up report on the Department.

The program has quickly delivered a substantial amount of technical assistance.

21.50 The studies made other recommendations that have not yet been implemented. They include completing country strategies for the program countries; developing criteria to evaluate the success of individual projects; putting in place a mechanism to consult with stakeholders; gathering and disseminating commercial information on a systematic basis; and focussing more strategically on commercial opportunities.

Program Effectiveness

The evaluators were not asked to assess the long–term impact, such as whether and to what extent Canadian technical assistance had helped the recipient country in making the transition to democracy and a market economy.

21.51 As stated earlier, the Canadian technical assistance program has three primary objectives: to support the transition to market economies; to support democratic development; and to increase Canadian trade and investment links with the region. This section reports the conclusions of the evaluations carried out to date.

An evaluation concluded that the program has quickly delivered a substantial amount of technical assistance in appropriate sectors

21.52 The evaluation of the technical assistance program concluded that the activities of the program had contributed to and supported these objectives by quickly implementing a large number of projects in several countries in sectors consistent with the mandate given by Cabinet. It went on to say that "this approach has been effective to date." The evaluation also stated, based on its analysis of randomly selected projects and on a survey of respondents who had received money from the program, that "significant impacts, such as transfer of knowledge, have already been realized."

21.53 The evaluators were not asked to assess the long–term impact of technical assistance, such as whether and to what extent Canadian technical assistance had helped the recipient country in making the transition to democracy and a market economy. The evaluation pointed out that the "impacts" measured were necessarily short–term because the program was not advanced enough at the time of the evaluation to measure its long–term impacts.

21.54 The Department points out that it is not practicable to measure the impact of the technical assistance provided by any individual donor, big or small, at the country level. This is because many donors are providing assistance to the same country, often in the same sector, and sometimes several donors may be co–financing the same project. Thus, it is virtually impossible to isolate the impact of discrete technical assistance projects at the country level and to attribute the impact to individual donors. The Department points out that even the big donors (and Canada is quite small in comparison) will not have a measurable impact at the country level unless an appropriate enabling policy and legal framework are put in place by the country receiving assistance and unless adequate local financial resources are available.

21.55 The Department holds the view that donors will eventually have a significant impact through their collective efforts, but that this can be assessed only over the long term. We believe that it would be useful to "stand back" periodically to assess what progress is being made and what adjustments are

required to maximize the effectiveness of the collective effort. The Department points out that this is not necessary at this time because the International Monetary Fund, the World Bank and the European Bank for Reconstruction and Development among them undertake ongoing macroeconomic assessment of progress in the region as well as detailed country and sector assessments. The Department does not believe that it is feasible to carry out a "standback" assessment. It indicates further that a multi–donor evaluation would be unacceptable to most, if not all, receiving countries on political grounds.



Canadian technical assistance supports the introduction of up-to-date methods and technology. This project in the Czech Republic involves the use of remote sensing technology to improve land management (see paragraph 21.57).



Canadian experts have provided training to Russian dairy farmers in current technology and practices (see paragraph 21.57).

A more strategic focus will be needed to maximize the long–term potential of trade and investment opportunities

21.56 Program activities complement the traditional trade development activities managed by the Department's Central and Eastern Europe Trade Development Division. The Renaissance Eastern Europe program, managed by this Division, accounts for part of the funds allocated to the technical assistance program.

A more strategic focus will be needed to maximize the long–term potential of trade and investment opportunities.

21.57 Trade and investment objectives are advanced by positioning Canadian companies through participation in technical assistance projects. This helps in three ways. First, it affords Canadian companies the opportunity to gain "on the ground" understanding of the region and its markets, identify upcoming opportunities and make contacts and establish networks. Second, such projects can be an effective way to demonstrate and prove Canadian technology and expertise. Finally, the establishment of appropriate financial, tax, investment, trade and contractual regimes and regulatory frameworks are essential for successful Canadian trade and investment. The program of assistance has supported a number of projects throughout the region that aim to improve the trade and investment environment.

The Department maintains that the commercial benefits of participation can be assessed only in the long run.

21.58 The issue of effectiveness here is whether and to what extent participation in technical assistance projects has resulted in commercial benefits, such as incremental sales of goods and services, for Canadian firms. The evaluation of the Renaissance program (roughly 5 percent of total technical assistance) indicated that the program remains relevant, that Canadian companies who had received support reported significant and incremental impacts, and that it was being delivered effectively and efficiently.

21.59 The Department maintains that it is too early to make an assessment of all technical assistance at this stage since the program is less than five years old, and the commercial benefits of participation can be assessed only in the long run.

21.60 We also believe that commercial benefits will not necessarily flow automatically simply because Canadian expertise has been demonstrated. Canadian expertise is not unique, and there is intense competition in the region, with every donor vying for a share of the same commercial pie. We think that a focussed and sustained effort will be necessary to realize these benefits.

21.61 The evaluation of the technical assistance program pointed out that "in terms of positioning Canadian companies, a more strategic and less ad hoc approach for the future will likely result in Canadian businesses being in a stronger position to compete on an international level." The evaluation went on to say that "failure to provide more focus to the commercial activities of the program will come at tremendous cost and lost opportunities." The evaluator of the Renaissance program noted that business information gathered in the region is not being disseminated to Canadian companies interested in doing business in this part of the world.

21.62 We believe that the important question facing the Department at this time is whether its present approach to consultation and planning, information gathering and dissemination, and follow–up of opportunities is adequate and strategic enough to derive the maximum benefit from the potential that exists.

21.63 The Department has stated that:

> Ongoing consultation and co-ordination consultation takes place between the Bureau of Assistance and

the Department's Central and Eastern Europe Trade Development Division to share information and maximize commercial opportunities and benefits. The Renaissance program is managed by the Trade Development Division to ensure that its activities contribute directly to and support Canadian trade interests and objectives in the region. Representatives from the Bureau and the Trade Division are permanent members of the two programs' Project Review Committees. In addition, informal consultation with regard to issues of shared interest takes place both at headquarters and with missions on an ongoing basis. Finally, the program participates in the development of the Department's International Trade Plan and is a member of the Interdepartmental Committee on International Financial Institutions Procurement.

The Department agrees with us that the question of developing a more strategic focus on commercial activities will require further examination.

21.64 This audit refers to two evaluations and a financial management review of the program; we wish to emphasize that we refer to them only for the purpose of illustrating the Department's practices in managing this program. Indeed, because the assistance program has been operating for less than five years, and because of the difficulty of assessing the impact of such assistance in the short term, we deliberately focussed our work on the Department's management practices in setting up and operating the program. While we commend the Department for undertaking these studies, we do not express a view on their quality or on the program's "on the ground" effectiveness.

Project Management

21.65 Rapid growth in the scope and volume of technical assistance contributions, combined with shortage of staff at departmental headquarters and in missions, resulted in insufficient attention being paid to project management in the early stage of the program. Project selection criteria were unclear; monitoring was insufficient and ad hoc; and no evaluation, auditing and results measurement were undertaken during the period from inception of the program until December 1992, when the first project audits were initiated.

Insufficient attention was paid to project management in the early stage of the program.

The Department is taking the necessary steps to become more results–oriented

21.66 Since December 1992, the Department has adopted a more results–oriented project management approach and has initiated a number of steps in this direction.

21.67 The project proposal assessment process has been improved. Good project management starts with project selection based on an assessment of the risks involved and the factors that are critical to the eventual success of a project in meeting its objectives. Experience with Canadian assistance programs in other parts of the world has shown that a careful assessment of such factors at the outset significantly increases a project's chances of success.

The Department is taking the necessary steps to become more results–oriented.

21.68 The specific factors that need to be assessed will obviously depend on the nature of the project, but some of the common ones are:

- the commitment of the executing agent and the recipient organization;
- their managerial and technical capability;
- the availability of resources, including financial resources, that will be

needed to sustain the project after donor assistance comes to an end; and

- the involvement of the beneficiary recipient organization in the design and evaluation of the project.

21.69 The Department agrees that these and other factors are important. As mentioned, it has revised guidelines for preparing project proposals to specify more clearly the kind and extent of information required before new project proposals will be considered for funding. In this way, it expects to improve the assessment of new project proposals and, consequently, the quality of projects in its portfolio. The Department also agrees with our view that mission staff can play a vital role in providing input to proposal assessments in the planning stage of the project.

Project selection based on an assessment of the risks involved and other critical factors increases the project's chances of success.

21.70 Project monitoring in the field has been strengthened. The next important step in project management is ongoing monitoring, that is, tracking the progress of projects against their potential for success. Monitoring that focusses on compliance with procedures and process is useful for the intended purpose, but it does not by itself provide results–oriented information on whether the project is making sufficient progress toward its objectives. Properly trained field staff, whether Canada–based or locally engaged, can make a big contribution to project monitoring. Being "on the ground", field staff are closest to the project, know the country and its conditions, and have ready access to executing agents and recipient organizations.

Ongoing project monitoring, that is, tracking the progress of projects against their potential for success is critical.

21.71 CIDA's experience in the field over many years, and particularly in the recent decentralization exercise, has shown that posting additional staff abroad does not by itself lead to better monitoring or better results. What is critical is that the right kind of monitoring is done by competent staff with a strong sense of purpose. This requires a clear definition of what is to be monitored, how it is to be reported and what action will subsequently be taken.

21.72 The Department recognizes the importance of an increased field presence and involvement in project management. Until recently, mission staff played a limited role in project management, such as screening project proposals for consistency with country needs, assessing host organizations and conducting monitoring. Although project monitoring has always been a component of the work of mission field staff, due to lack of resources it has not been carried out in a systematic manner. Monitoring is expected to be strengthened with the posting of 10 Canada–based technical assistance officers and additional locally engaged staff in seven program country missions. Field staff are expected to play an increased role in project monitoring.

21.73 Project monitoring guidelines were revised during 1993–94 and a number of project monitoring contracts have been given out. The terms of reference for project monitors emphasize the provision of results–oriented information and define what is to be monitored, how it is to be reported and what action is to be taken. In addition, criteria are in place to measure the potential for results and project impacts.

21.74 We suggest that the Department consider using locally engaged staff with the appropriate knowledge and skills, where possible, for project monitoring since this could be done at significantly lower cost.

21.75 Project evaluations to measure results are under way. The last step is periodic "stand back" evaluation and this should have a dual focus: first, a periodic

evaluation to assess whether the system of ongoing monitoring is effective in providing results–oriented information on the projects being monitored; second, a post–completion evaluation to assess whether projects have achieved the results expected from them. This post–completion evaluation should identify what results were achieved as well as what was not achieved and why not. Important lessons could be learned for the future about what works and what does not.

21.76 The Department acknowledges the importance of periodic program and project evaluations. An evaluation strategy has been developed and, as of June 1994, there were over 40 project evaluations either under way or near completion to assess whether anticipated results are being achieved. These evaluations are expected to include identification of the results that are likely to be achieved, as well as those not likely to be achieved and why not. In addition, lessons learned from these evaluations are expected to be applied in the Department's operations.

21.77 With respect to evaluation of its ongoing monitoring system, the Department has indicated that it is too early to undertake one at this stage.

21.78 In our view, the steps taken by the Department are too recent for an assessment of their effectiveness at this time. However, we intend to conduct an assessment of these actions in our follow–up audit of the Department.

Audit of Contributions

21.79 The Department's technical assistance program is a contributions program. Contributions are conditional transfer payments and require a formal agreement between the donor and the organization receiving the funds. In these agreements, terms and conditions governing every payment are identified, including allowable expenditures, payments conditional on performance and provision for audit. Treasury Board requires that program managers, as trustees of public resources, ensure that the terms and conditions of a contribution are complied with. For example, managers must ensure that recipients account fully for contributions and use them exclusively for the purposes intended in the contribution agreement.

21.80 Moneys for the Department's technical assistance contribution program are appropriated by Parliament. As Parliament's auditor, the Auditor General has a duty under section 7(2)(c) of the *Auditor General Act* to report cases in which he has observed that "money has been expended other than for purposes for which it was appropriated by Parliament." In order to fulfil our duty to Parliament, we set out to determine in this audit whether and to what extent the Department obtains independent assurance that contributions have been spent for purposes intended by Parliament. In this regard, we reviewed project audits that had been done for the Department by outside auditors.

The Department is taking steps to make more explicit the nature and extent of assurance sought from audit

21.81 In December 1992, the Department audited five projects completed between 1990 and December 1992 selected on the basis of risk and materiality. Subsequently, five additional projects identified by project officers who were having difficulty in obtaining timely and complete financial information from executing agents were also audited. All 10 projects selected for audit were materially large projects, each involving

Post–completion project evaluation should identify what results were achieved as well as what was not and why not.

Managers must ensure that recipients account fully for contributions and use them exclusively for the purposes intended.

contributions in excess of $250,000. Seven of the 10 audits had been completed at the time of our examination. What the departmental auditors found was that, in all material respects, over 90 percent of the contributions (roughly $4 million) had been spent in accordance with the terms and conditions of contribution agreements. The auditors identified roughly $327,000 in claims that did not meet the criteria for allowable expenditures and informed the Department accordingly. Some of these amounts were subsequently recovered by the Department, others have been adjusted against future payments, and the remaining amounts have been accepted as allowable by the Department on the basis of additional explanations provided by the executing agents.

21.82 The Department has indicated that the focus of these 10 audits was on compliance with the terms and conditions of the contribution agreement in accordance with Treasury Board policy on the audit of federal contributions. The auditors pointed out that, based on their audit opinion, "one can conclude that in all material respects, the audited amount represents costs incurred by the contractor and claimed from the Department which comply with the terms and conditions of the contribution agreement."

The Department is taking steps to make more explicit the nature and extent of assurance sought from audit.

21.83 The audit opinions issued by these auditors do not refer to "the use of funds for the purposes intended by Parliament." This is not a criticism of the present arrangements. The Department's auditors performed the work in accordance with government auditing policy and standards. In raising this issue, we are not implying that money was spent other than for the purposes intended by Parliament. Our concern is with the ability of the present system to minimize the risk of occurrence of such incidents.

21.84 The Department has informed us that, based on discussions with its auditors, conducting work to meet the requirements stated in section 7(2)(c) of the *Auditor General Act* may entail additional procedures, effort and cost. The Department has also told us that the merits of the change in wording in the certification statement provided by its auditors is an issue that needs to be resolved by Treasury Board in respect of government auditing policy on contributions. The Department has indicated that it is prepared to discuss this matter with the Comptroller General of Canada.

21.85 The Department has recently implemented a new audit plan for technical assistance contributions. Following its consultants' recommendations, the Department has taken a number of steps to improve the audit of technical assistance contributions. Contribution agreements have been improved to clearly reflect the purposes for which moneys are to be used and the accountability of the recipient. The Department now also requires its auditors to bring to its attention instances where funds are not being spent for the purposes intended. It also points out that audits are one of several management mechanisms, some others being monitoring and evaluation, which, when applied systematically, provide assurance that moneys are spent for purposes intended.

21.86 In addition, the Department has recently introduced an annual audit plan in which a sample of active projects, selected on the basis of risk and materiality and also at random, will be audited every year. Since no projects have yet been audited under this plan, we cannot comment on its implementation. However, we propose to examine it in our follow–up audit of the Department.

Reporting to Parliament

The quality of information provided to Parliament needs to be improved

21.87 Stewardship reporting. In Chapter 6 of our 1992 Report, we refer to departmental stewardship reporting as encompassing the overall management and accountability of the minister and senior public servants for the entire range of their duties and obligations. Annual reporting that focusses on compliance with spending authority does not reflect these broader duties and obligations. Stewardship reporting, therefore, is far more extensive than reporting on annual spending.

21.88 Parliament has a right to know how effectively moneys are spent. Thus, parliamentarians require a regular accounting on the exercise of responsibilities delegated to ministers. The Minister of Foreign Affairs is responsible to account to Parliament for the results of the program of technical assistance for Central and Eastern Europe and the former Soviet Union that is being managed by his Department.

21.89 Departmental Part IIIs. The Department's Part III of the Estimates represents the main reference document reporting on the Department's activities, and claims to contain performance information for each activity undertaken by the Department. We examined several recent departmental Part IIIs to determine how and to what extent the Department reports on the results of the program of assistance to Central and Eastern Europe and the former Soviet Union.

21.90 We found, in the subsection titled "Bilateral Relations and Co-operation with Europe", considerable narrative on the program's rationale, principal recipient countries, priority sectors, types of assistance, and past, current and future activities. This kind of information on the program provides useful background and a context in which to judge the results of the program.

21.91 Important information is missing. However, information that we believe is central to high–quality stewardship reporting is missing. For example, public documents do not provide substantive information on the magnitude of the program, its strategic targets and objectives, its plans and the indicators that would help in judging the program's results, or on actual results achieved.

21.92 Need for transparency. Transparency in information reported by the Department on any program of assistance is critical for demonstrating the value of the program and how effectively it is managed. This is particularly important in the case of the technical assistance program. The program was launched without specific enabling legislation. Consequently, the policy base for the expenditures involved could not undergo the full scrutiny of Parliament when it was introduced. It would be useful if the Department could provide parliamentarians with a periodic performance–oriented report on its technical assistance program. In these hard economic times, with concerns about government deficits and debt, parliamentarians need information to help make difficult choices among competing demands for scarce resources.

21.93 The Department points out that it has fully met the existing requirement for information, reporting guidelines and organizational format for Part III of the Main Estimates as determined by Treasury Board. In addition, it suggests that we should raise with Treasury Board our concerns about reporting to Parliament on the program because this is a

Public documents do not provide substantive information on the program's magnitude, its strategic objectives, its plans and the indicators to measure results, or on actual results achieved.

government–wide issue. We wish to point out that, although the Department may be following the Treasury Board reporting guidelines for Part IIIs, there is nothing stopping it from being more innovative in providing more and better information on this program.

Conclusion

21.94 The end of communism in Central and Eastern Europe and the former Soviet Union presented a unique opportunity for Canada to participate and assist in effecting fundamental political and economic transformations in many countries in the region. Despite conditions characterized by uncertainty, rapid change, enormous needs and multiple players, the Department succeeded in implementing the Canadian program of technical assistance very quickly.

21.95 We recognize that, in managing the program, the Department had to "learn to run before it could walk." We also recognize the challenge and complexity of attempting to measure the success of a program whose objectives can likely be achieved only in the long run.

21.96 Our audit indicates that the Department has made a substantive and timely attempt to assess program management and has recently taken significant steps to make it more results–oriented. The value of these steps will be tested only in the future.

21.97 However, several challenges and concerns remain regarding the Department's ability to assess the effectiveness of the program in such a complex environment.

- A long–term approach and strategy are needed at the front end, given the number of stakeholders and the long time horizon for achieving and evaluating results. The key questions that need to be addressed are, what do we want to achieve, what are the key indicators of success, how and when do we check progress and how do we report on effectiveness?

- Because it is not practicable to assess the impact of individual donors on promoting democracy and the transition to market economies, there is a need to assess the feasibility of conducting a co-ordinated assessment by several donors of the effect of their collective efforts.

- Encouraging as short-term investment successes may be, the real commercial benefits are likely to accrue only in the long run. Departmental evaluations have pointed out that in order to maximize the full potential of the trade and investment opportunities available in the region, the Department may need to develop a more strategic focus.

21.98 Finally, in managing this program of contributions, the Department needs to pay particular attention to the notion of comptrollership and to build on the significant steps it has already taken. (This issue is addressed in considerable depth in Chapter 22, paragraph 22.56 of this Report.) There is an opportunity to improve the quality of information the Department provides to Parliament on the results of the program.

There is a need to assess the feasibility of conducting a co–ordinated assessment by several donors of the effect of their collective efforts.

Chapter 22

Foreign Affairs and International Trade Canada

Financial Management and Control

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Foreign Affairs and International Trade Canada

Financial Management and Control

Assistant Auditor General: Richard B. Fadden
Responsible Auditor: Vinod Sahgal

Main Points

22.1 Foreign Affairs and International Trade Canada (the Department) spent $1.4 billion in 1993–94 on programs to promote and defend Canadian interests and serve Canadians at home and abroad. Parliamentarians and this Office have long been concerned with the prudence, probity and financial management and control of these programs. Our audit was designed to monitor the degree to which the government is addressing this concern.

22.2 There have been improvements in financial management and control in many areas since our last major audit of this aspect of the Department in 1987. A substantive effort has been made over the last two years. For example, the financial accounting system has been strengthened and there is increased awareness that cost is an important element in decision making. The need to link cost with results should follow.

22.3 The war is not yet won. Further progress is needed in many areas. The Department realizes that this will require a sustained effort over a period of time. Strong leadership will be necessary to encourage acceptance of financial management and control as a management priority throughout the Department worldwide.

22.4 There are distinct opportunities to deliver programs and related services more cost–effectively through the use of information technology and a more results–oriented management style, and through changes in the way foreign service allowances and properties are managed by the Department and the Treasury Board.

22.5 Where appropriate, increased delegation of authority from the Treasury Board to the Department could facilitate the realization of these opportunities.

22.6 We propose to keep a watching brief over further progress in the areas of concern.

Introduction

Mandate

22.7 The mission of Foreign Affairs and International Trade Canada (the Department) is to portray, promote and defend the interests of Canada and the common values of Canadians; to improve Canadians' awareness and understanding of the world; and to serve Canadians at home and abroad.

22.8 The Department draws its legislative authority from the *Department of External Affairs Act*. The Minister of Foreign Affairs manages the broad mandate of the program with the Minister for International Trade. Below the ministerial level, the Department's senior management consists of the Deputy Minister of Foreign Affairs, the Deputy Minister for International Trade and the Associate Deputy Minister of Foreign Affairs. Support is provided to the ministers by the Secretary of State for Latin America and Africa and the Secretary of State for Asia–Pacific. (A departmental organization chart is provided in Exhibit 22.1.)

22.9 The Department represents Canada in 146 locations in 98 countries around the world. There are 111 missions plus 35 other satellite offices.

22.10 The powers, duties and functions of the Minister of Foreign Affairs are defined in the *Department of External*

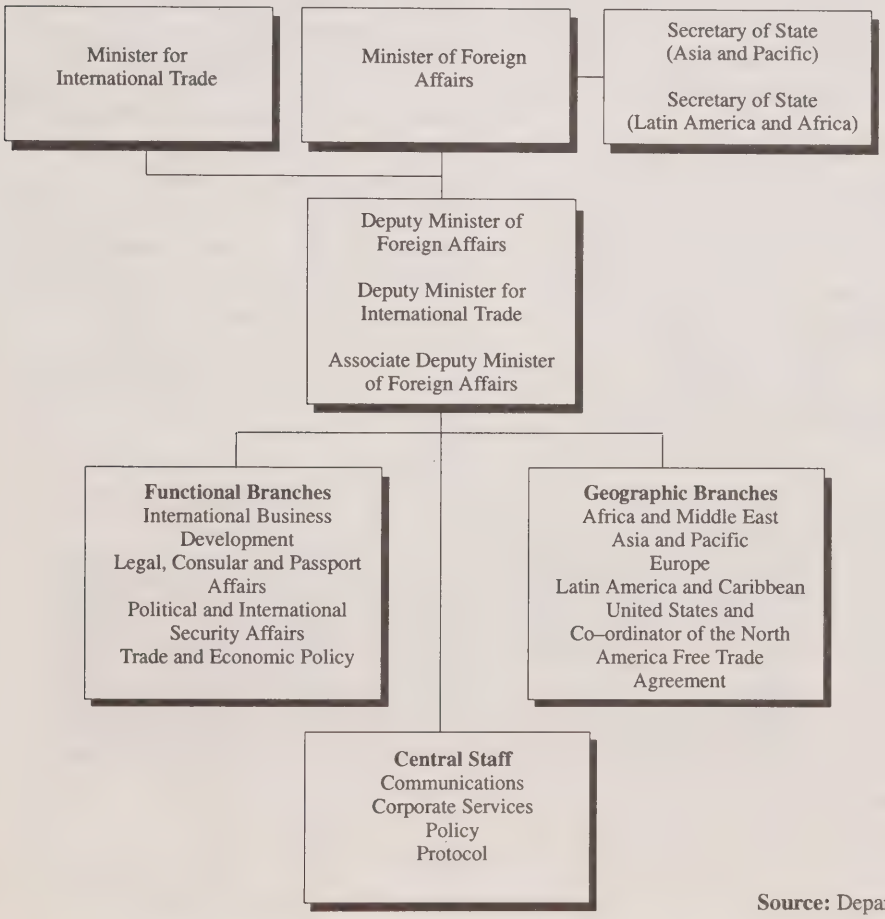


Exhibit 22.1

Departmental Organization Chart

Source: Departmental Organization Chart (August 1994)

Affairs Act. This stipulates that the Minister shall:

- "co-ordinate the direction given by the Government of Canada to the heads of Canada's diplomatic and consular missions;

- have the management of Canada's diplomatic and consular missions; and

- administer the foreign service of Canada."

22.11 The *Department of External Affairs Act* stipulates that "a head of mission shall have the management and direction of his mission and its activities and the supervision of the official activities of the various departments and agencies of the Government of Canada in the country or portion of the country or at the international organization to which he is appointed." Heads of mission are appointed by Governor in Council.

22.12 A head of mission is accountable for all mission operations. In this context, the post abroad is a microcosm of the Government of Canada as a whole. Program and administrative staff posted abroad report directly to the head of mission, who is answerable to the deputy ministers in Ottawa for program delivery and administration of the mission.

The Department's expenditures have increased from $ 982 million in 1988–89 to $ 1,421 million in 1993–94

22.13 The Department provides administrative and operational support (common services) for other departments and agencies represented abroad, such as the Canadian International Development Agency (CIDA), the Department of Citizenship and Immigration and the Department of National Defence. The presence abroad of all other departments and agencies is significant. More than half of all program staff working abroad are engaged in the programs of other organizations.

22.14 Support involves providing real property, materiel management and related services; managing locally engaged support staff; managing information technology and communications facilities; managing records; and providing security and financial, personnel and general administrative support to employees and their families.

22.15 The Department has estimated the cost of providing common services to other government departments at the missions to be $176 million in 1993–94. This figure represents 20 percent of its total operating expenditures. However, it excludes an allocation for headquarters overhead expenditures, as explained in paragraph 22.67.

Departmental Expenditures

22.16 The Department's expenditures have increased from $982 million in 1988–89 to $1,421 million in 1993–94. This represents an increase of $439 million in current dollars, or 45 percent in the last five years. As shown in Exhibit 22.2, the growth in expenditures for grants and contributions accounted for $292 million of this increase. The bulk of the increase in grants and contributions is due to the following factors:

- Canadian involvement in peacekeeping and membership in the United Nations ($132 million);

- contributions for assistance to Central and Eastern Europe and the former Soviet Union ($84 million); and

- contributions toward membership in other international organizations and payment to the Canadian Broadcasting Corporation for Radio Canada International ($74 million).

22.17 The balance of the increase of $147 million is due to an increase of

$151 million in operating expenditures and, at the same time, a decrease of $4 million in capital expenditures. According to the Department, the increase in operating expenditures is explained mainly by the inflation affecting departmental salaries and operations abroad. The Department has also noted that increases in workload and the cost of new policy initiatives were offset by budget cuts of $100 million in existing operations and of $40 million in program transfers to other government departments.

Organization and Resources

22.18 Decision making in the Department is heavily centralized at headquarters in Ottawa. The geographic branches and the Corporate Services Branch provide direction and support to missions to carry out policy and programs abroad.

22.19 Missions abroad fall into two categories:

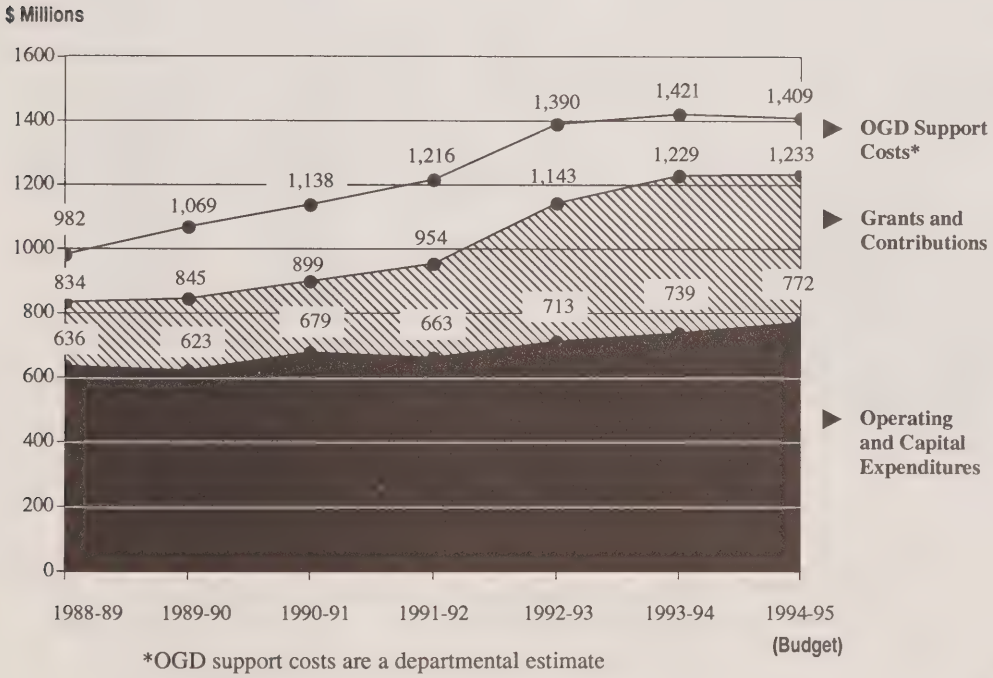
- Bilateral missions are accredited to specific countries and organized functionally. These include larger missions that manage a full range of programs, such as political relations, trade, immigration, and CIDA; they also include smaller missions that specialize in some of these programs.

- Multilateral missions serve Canadian interests in specific international organizations, such as the United Nations, the Organization for Economic Co-operation and Development and the North Atlantic Treaty Organization.

22.20 During 1994, Foreign Affairs and International Trade Canada employed 8,183 full–time equivalents worldwide. Of these, 2,433 are at headquarters and 5,750 are abroad. The full–time equivalents abroad are either Canada–based staff or locally engaged

Exhibit 22.2

Growth in Expenditures from 1988–89 to 1994–95 (Current Dollars)



*OGD support costs are a departmental estimate

OGD – Other government departments and agencies

Sources: Departmental Part III Estimates and Public Accounts of Canada (1993–94)

staff representing 1,127 and 4,623 full–time equivalents respectively.

22.21 From an historical perspective, the use of locally engaged staff in missions has increased, while the number of Canada–based staff has decreased. Exhibit 22.3 outlines the change in the distribution of personnel abroad for all departments over the past five years. During this period, Canada–based full–time equivalent staff abroad were reduced by about 300 and locally engaged staff increased by about 200. However, this does not constitute a net reduction in staff for all departments but rather a shift back to headquarters of staff posted abroad in some departments such as CIDA.

22.22 Departmental staff abroad are employed in five geographic regions. The

Exhibit 22.3a

Changes in Numbers Abroad of Canada–Based Staff (CBS) and Locally Engaged Staff (LES) for all Departments from 1988–89 to 1993–94

There was an overall reduction in full–time equivalent staff abroad between 1989 and 1994.

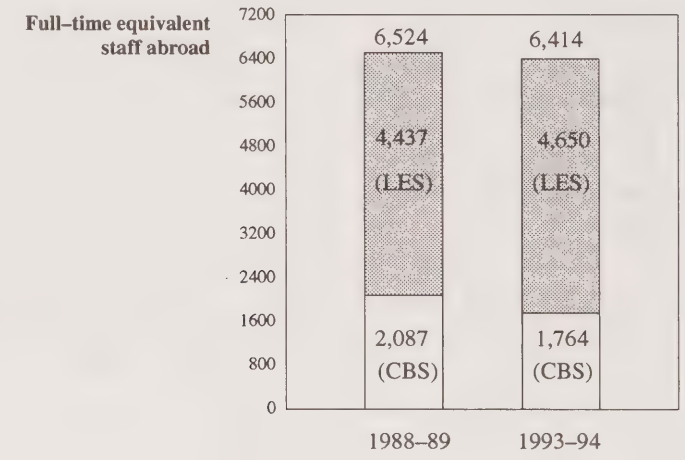
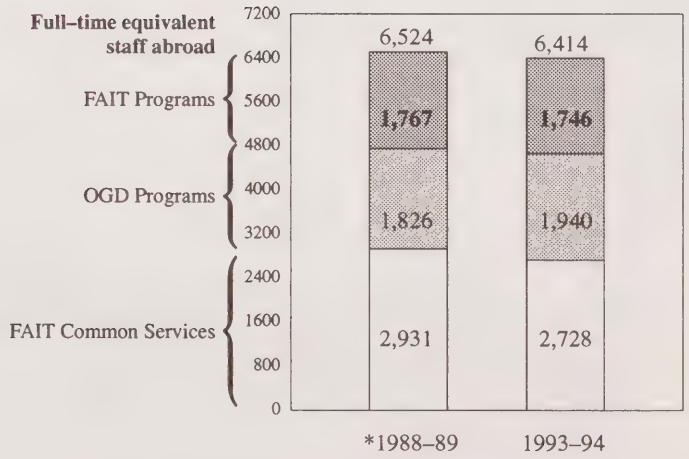


Exhibit 22.3b

Changes in Staff Distribution Abroad for Delivery of FAIT Programs, FAIT Common Services and Programs of Other Government Departments from 1988–89 to 1993–94

Over the last five years, there has been an overall reduction in full–time equivalent staff delivering FAIT programs, including common services. Over the same period, there has been an increase in staff delivering programs of OGDs.



* 1988–89 OGD figures have been adjusted to reflect program transfers such as the transfer of immigration services from FAIT to the Department of Citizenship and Immigration.

OGD – Other Government Departments and Agencies

FAIT – Foreign Affairs and International Trade

Source: FAIT Personnel Utilization Profile Exercise

greatest concentration of staff is in Europe, where 26 percent of Canada–based and locally engaged staff abroad are located. Canada has 36 missions and offices in 30 European countries. Staff are also located in Asia and the Pacific region (25 percent), Africa and the Middle East (20 percent), Latin America and the Caribbean (14 percent) and the United States (12 percent). The remaining 3 percent are with various international organizations.

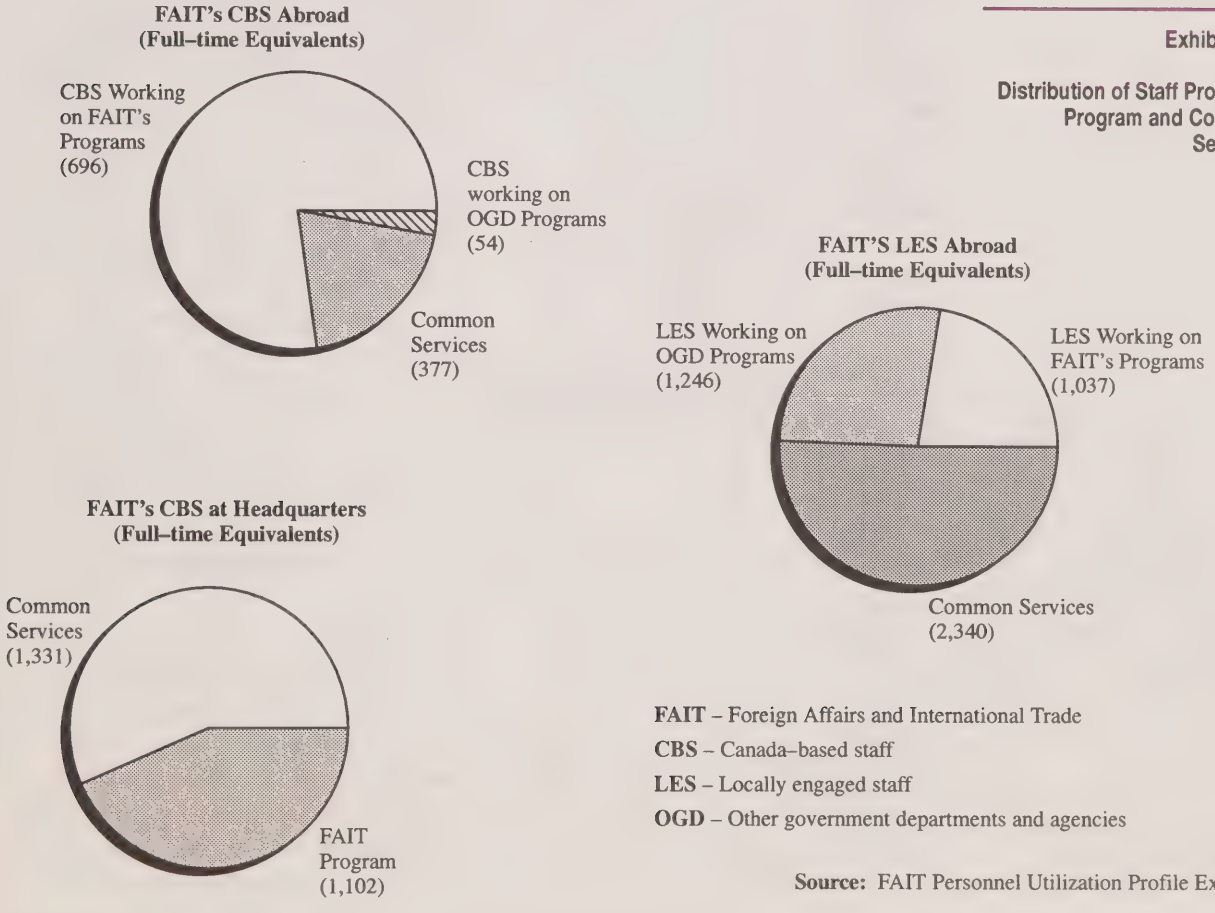
22.23 Other government departments employ a further 637 Canada–based and 27 locally engaged staff abroad. The Department estimates that 1,246 of its locally engaged staff are allocated to the program activities of other government departments.

22.24 Approximately half the Department's workforce or 4,048 full–time equivalents are engaged in providing common services in Canada and abroad. Common services include activities such as administration, finance and human resource and property management. The distribution of the Department's common services and program personnel between headquarters and abroad is illustrated in Exhibit 22.4. There are 2,717 full–time equivalents providing common services abroad, of which 2,340 are locally engaged and 377 are Canada–based. Common services abroad support programs of the Department and programs of other government departments.

Approximately half the Department's workforce or 4,048 full–time equivalents are engaged in providing common services in Canada and abroad.

Exhibit 22.4

Distribution of Staff Providing Program and Common Services



FAIT – Foreign Affairs and International Trade
CBS – Canada–based staff
LES – Locally engaged staff
OGD – Other government departments and agencies

Source: FAIT Personnel Utilization Profile Exercise

22.25 One third of the Department's Canada–based foreign service officers are dispersed around the world at any one time. Thus, the Department needs people who are rotational, that is, ready to serve abroad. Two thirds of all Canada–based staff are listed as rotational.

22.26 Canada–based staff are abroad, on average, for three years. Some post conditions allow for two–year posting cycles — 25 percent of the Canada–based staff abroad are at these missions. The remaining 75 percent of staff are on three– or four–year assignments.

22.27 Canadian missions and offices are rated according to the varying degrees of hardship to which employees are deemed to be subjected while located there. There are six hardship levels, ranking from least hardship (level 0) to most hardship (level 5). Conditions such as isolation, climate, medical care and violence/hostility are all examined by an interdepartmental Hardship Posts Committee. Exhibit 22.5 shows the number of missions and offices by hardship level worldwide in June 1994. Of the 146 missions and offices, 56 were identified as 0–level posts.

Issues of prudence, probity and weak financial management and control have been recurring themes in reports by our Office.

Exhibit 22.5

Post Hardship Ratings

Foreign Affairs and International Trade Canada has 146 posts abroad operating under differing conditions of hardship. Posts are rated from 0 (least hardship) to 5 (most hardship).

	Missions	Offices	Total
Level 0	46	10	56
Level 1	5	1	6
Level 2	10	2	12
Level 3	20	1	21
Level 4	17	4	21
Level 5	13	8	21
Not Rated *	0	9	9
	111	35	146

* No hardship rating is determined where foreign service directives do not apply.

Source: Foreign Affairs and International Trade Canada (1994)

Financial Management Infrastructure

22.28 Exhibit 22.6 shows the organization of the Department's financial function. It illustrates where the key financial officers are located in the Department and their relationships with the Assistant Deputy Minister, Corporate Management (Senior Financial Officer), the Senior Full–time Financial Officer and program branches. This chart shows the many stakeholders involved in the financial function both in headquarters and in missions abroad. In addition, it shows the wide span of activities under the responsibility of the Senior Financial Officer and the limited scope of the operating responsibilities of the Senior Full–time Financial Officer.

Our Previous Financial Management and Control Audit Work at the Department (1987–93)

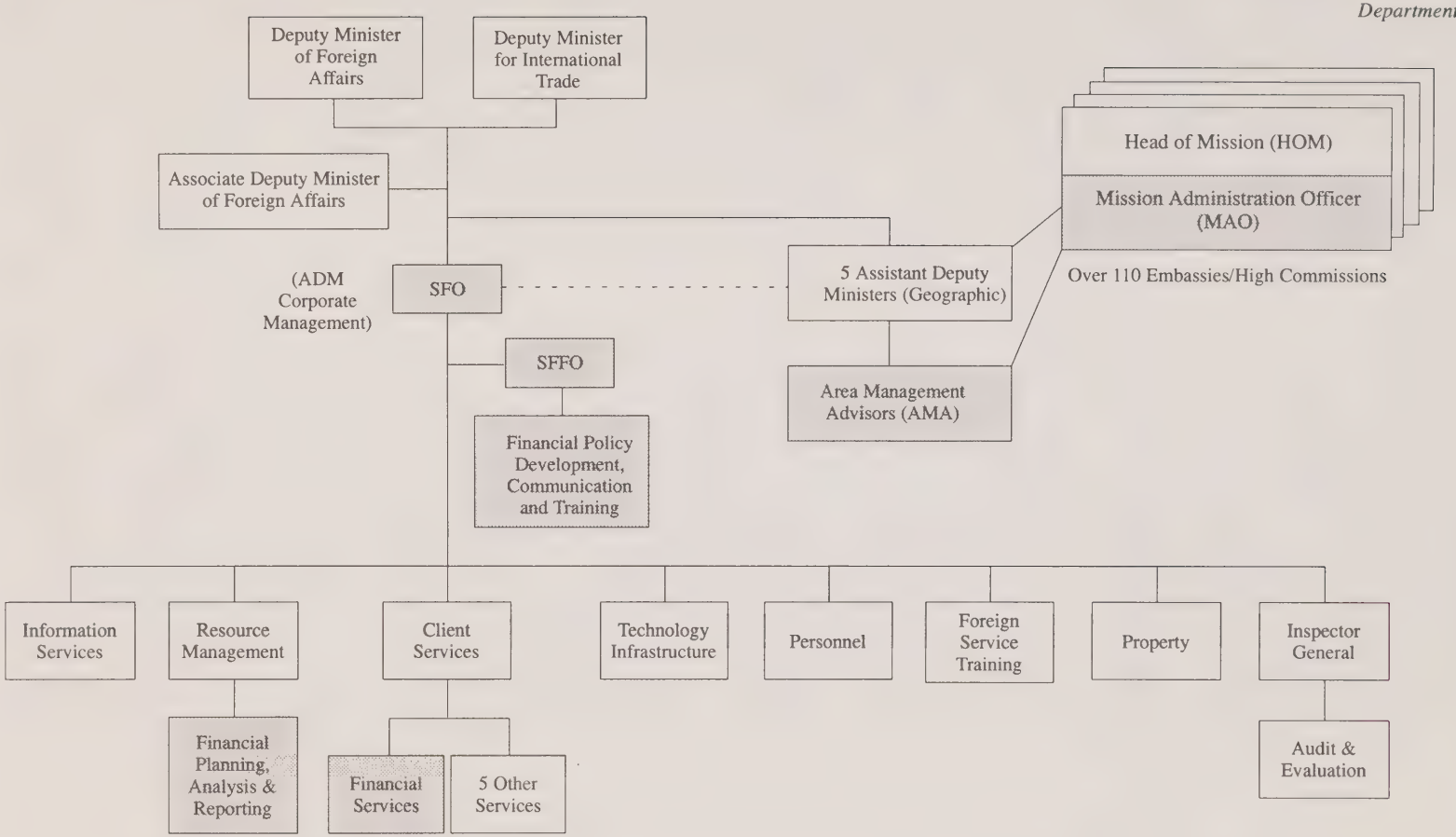
22.29 Issues of prudence, probity and weak financial management and control have been recurring themes in reports by our Office and the Department's Office of the Inspector General. The national audit offices of other nations, including the United States, Australia, France and Britain, have raised similar concerns about their own foreign services. This suggests that the foreign service community has had repeated systemic problems in these areas that have not been fully resolved. It also raises the question: What priority should be given to financial management and control within the foreign service environment?

22.30 Our last comprehensive examination of the Department's common administrative services was reported in our 1987 Report. We stated at that time that improvements were necessary in areas such as financial management and control; real property management; foreign service

Exhibit 22.6

Organization of the Financial Function

Key financial officers are dispersed throughout the Department



SFO – Senior Financial Officer (ADM Corporate Management)

SFFO – Senior Full-time Financial Officer

ADM – Assistant Deputy Minister

Key Financial Officers

Source: Foreign Affairs and International Trade Canada (1994)

directives; telecommunications; and internal audit and program evaluation.

22.31 In our 1989 follow–up report, we stated that progress had been slow in implementing the major changes to processes and systems needed to address the issues identified in 1987. The Department responded to this concern with the statement that factors beyond its control, such as the decentralization of the aid delivery program to missions abroad, had contributed to the delays.

It was unclear how well the Department's initiatives were addressing the root causes of its financial management and control problems.

22.32 Section 10 of the *Auditor General Act* obliges us to report to the President of the Treasury Board cases where it appears that public money has been improperly retained by any person. In 1990, pursuant to this section, we wrote to the President of the Treasury Board outlining our concern about the lack of financial control over money advanced to departmental employees. We also pointed out that, based on audit work completed over the past few years in the Department in the area of financial management and control, we believed there was a need for a thorough examination of the role, authority and organization of departmental senior financial officers and of the support provided to the financial function of the Department. In the same year, we reported to Parliament on the need to improve the control of money advanced to employees.

The link between cost and results was not a predominant feature of the Department's ongoing management information system.

22.33 Since 1990, we have continued to monitor the Department's efforts to resolve such concerns. Our general observation during the period 1990–92 was that progress was being made but that it was too early to assess the full impact of the changes. Meanwhile, the Department continued to pursue several initiatives to improve financial management and control and anticipated that, in due course, those initiatives would produce the desired results.

22.34 In 1993, with a growing number of reports highlighting incidents of waste and abuse in the Department, we increased our monitoring efforts in preparation for this audit.

22.35 Our monitoring work led us to the following interim conclusions at the end of 1993:

- The Department was investing heavily in attempts to address certain known accounting and control problems.
- The Department had implemented extensive detective procedures to identify weaknesses in financial administrative practices at Canadian missions.
- The Department was focussing on long–standing internal accountability issues.
- However, it was unclear how well the Department's initiatives were addressing the root causes of its financial management and control problems.
- The link between cost and results was not a predominant feature of the Department's ongoing management information system.

Audit Objective, Scope and Approach

22.36 **Objective.** The primary purpose of this audit was to ascertain the degree to which both substantive and sustainable improvements have been made to financial management and control in the Department.

22.37 **Scope.** This audit was aimed at two distinct but related levels. The objective of the first level of the audit was to determine the extent to which the Department had carried out the recommendations made by the Standing Committee on Public Accounts in its 1990 *Ninth Report to the House of Commons (Department of External Affairs*

Employees' Advances). The Committee issued this report following its hearing on the 1990 Report of the Auditor General.

22.38 The intent of the second level of the audit was to assess the quality of stewardship of resources entrusted to the Department by Parliament, with particular emphasis on the comptrollership aspect of management. To this end, we examined several areas: property management, foreign service directives, information technology, and the internal audit and program evaluation functions.

22.39 The key questions raised in this audit were:

- Comptrollership: Does the Department require a stronger comptrollership function?
- Property management: What specific benefits will flow to taxpayers from the special operating agency set up to manage, in a businesslike manner, the large inventory of departmental properties at its missions?
- Foreign service directives: Have the long–standing concerns over the monitoring of costs and the complexity of these directives been resolved?
- Information technology: Is the use of information technology improving the productivity and quality of services provided by the Department?
- Internal audit: Is there a need to further strengthen the role of this function?

22.40 **Approach.** We visited 10 missions to further our understanding of their financial controls and related procedures and to obtain input from heads of mission and their program managers for the design of this audit.

22.41 We did not specifically audit any missions but relied on the results of internal audits by the Department. Years of internal audit results have emphasized the importance of headquarters in resolving many of the weaknesses in financial management and control found at the missions. An essential element of our approach was to build on previous work done by our Office and the Department's Office of the Inspector General, which visits almost every mission once a year.

22.42 We focussed the majority of our work on the current corporate financial management and administrative infrastructure at headquarters and its impact on departmental and mission operations. Special emphasis was placed on examining planned and ongoing corporate initiatives to resolve long–standing problems in financial management and control.

22.43 Another key consideration was the Department's ability to promote cost–conscious behaviour and encourage efficiency. We encouraged the Department to search for and disseminate information on best practices, and we conducted a joint study with the Department of certain foreign service directives. This study includes a survey of similar public and private organizations in Canada and in other countries to determine how they provide compensation for serving abroad. We propose to provide the results of this study to the Department in due course.

Does the Department require a stronger comptrollership function?

Audit Observations

Follow–up to the Recommendations of the Standing Committee on Public Accounts

22.44 In 1990, as mentioned earlier, there was a hearing of the Standing Committee on Public Accounts on our

1990 audit note titled "Need to improve control of monies advanced to employees". We indicated at that time that our concern regarding advances to employees was but one example of several problems created by a lack of sound financial management and qualified financial and administrative staff in the Department.

22.45 We were convinced that there was a need for a thorough examination of the role, authority and organization of departmental senior financial officers and the support provided to the financial function of this Department. In addition, the then Auditor General informed the Committee that "the Department also needs to take a hard look at the attitudes of its employees toward financial management."

The effectiveness of the many recently implemented organizational changes, processes and procedures can be demonstrated only over time.

22.46 The Committee's *Ninth Report to the House of Commons*, issued in December 1990, made five recommendations to the Department. Exhibit 22.7 provides a summary of these recommendations together with our assessment of the actions taken by the Department.

Results of our current follow–up

22.47 The Department has addressed weaknesses in accounting controls and procedures, specifically, weaknesses in the control of money advanced to employees, in the collection of rent from employees, and in financial accounting at missions. The Department has also initiated improvements in the recruitment and training of qualified financial officers at headquarters and missions.

22.48 As encouraging as this is, it is not clear that these improvements can be sustained or that the root causes (discussed below) of many of the Department's problems have been fully dealt with.

22.49 The effectiveness of the many recently implemented organizational changes, processes and procedures can be demonstrated only over time. Lasting improvements to systems depend on how deputy heads and the Treasury Board deal with the following factors that affect sound financial management and control.

22.50 Accountability is unclear at times. For example, when monthly rents (shelter shares) remain unpaid for several months, who is accountable for ensuring that they are paid? Certainly, the employee has a responsibility to pay his or her rent on time. But surely the supervisor at the mission is also answerable in the case of a recalcitrant employee. Similarly, who is accountable if the deduction for rent is not made on a timely basis at headquarters? Finance Division? Personnel Division? or some other division? There is a need to clarify accountabilities and, wherever possible, designate a focal point for follow–up when a problem is detected.

22.51 Transactions and the accounting systems that support them are administratively complex. The unique nature of many accountable advances and the volume and complexity of the underlying transactions may at times require a different approach from that used by other government organizations. For instance, it is difficult to satisfy the Treasury Board requirement that stipulates that travel advances must be accounted for not later than 10 working days after the travel has been completed. Experience has shown that 10 working days is a difficult standard to meet in this Department; it may be possible to simplify accounting in this area to help meet the requirement. The government could learn from the many international organizations that are modernizing their systems with increased computerization, the use of

credit cards and simplified per diem travel advances. For example, the Export Development Corporation uses a system that combines these features.

22.52 We recognize that in the case of foreign service directives, the Department's ability to simplify accounting is limited. The Department indicates that the underlying complexity of the foreign service directives is beyond its control, since the Treasury Board Secretariat and the unions are heavily involved. This matter is discussed in greater detail in the foreign service directives section of this report.

22.53 Geographic dispersion is a unique element that adds to the Department's administrative burden. Pressure to open new missions makes efforts to deal with the administrative implications of geographic dispersion even more essential. To help ease the administrative burden, the Department has increased delegation of accounting control and procedures to the missions in areas such as the settlement of accountable advances; it has also implemented FINEX (an on–line worldwide financial information system) and SIGNET (a department–wide computerized message system).

22.54 The attitudes of employees will have to change. The support for and commitment to improved financial management and control ultimately rests with the individual employee at all levels. If employees do not behave in a way that fully supports improved financial control, any improvements the Department has made in its "systems" will ultimately not be sustainable.

22.55 In summary, while some improvements in financial management control procedures have been implemented, their sustainability is not yet assured.

Comptrollership

22.56 The Treasury Board, in defining good financial management, control and accountability, endorses the notion that all managers are trustees of public resources and requires that they be answerable for the use of those resources. Program managers have important responsibilities in this regard, as do financial officers. The Comptroller General of Canada has defined comptrollership as "the essential, integrated business processes that must be in place in any organization to:

- manage financial risks;
- understand the financial implications of decisions before they are taken;
- properly track and account for the financial transactions and operating results of all financial decisions; and
- protect against fraud, financial negligence, violation of financial rules and principles, and losses of assets."

22.57 In our 1992 Report (Chapter 4, "Change and Control in the Federal Government") we described the concept of "control" in its broadest sense of creating the conditions that lead to the achievement of objectives. Control is formalized in a variety of ways, including the use of mission statements, goals and objectives, policies and procedures, and standards and information reporting. It is informally exercised where the influences are ethics, values, trust or commitment and a results–oriented mindset. Having a good balance between formal and informal controls contributes to effective overall control. Furthermore, we stated that in government, sound control means having reasonable assurance that agreed standards of performance will be met while achieving probity, value for money and compliance.

If employees do not behave in a way that fully supports improved financial control, any improvements the Department has made in its "systems" will ultimately not be sustainable.

Exhibit 22.7

Summary of the Recommendations of the Standing Committee on Public Accounts with Our Assessment of the Actions Taken by the Department to Implement Them

A. The Department should ensure that all overdue advances to employees presently outstanding are subject to appropriate settlement or recovery action as soon as possible and that future advances are settled and recovered in strict conformity with Treasury Board and departmental policies.

Our 1990 audit note reported that, according to departmental accounting records, the amount of money advanced to employees that was still outstanding at 31 March 1990 was approximately $25 million. At that time, we concluded that there was no clear accountability within the Department for monitoring, follow–up and recovery of accountable advances (money advanced to employees). Results of a review that we conducted in 1993 and reported to the Standing Committee on Public Accounts indicated that the Department had settled all but an estimated $1.2 million of the original advances outstanding.

Our current audit findings in this area indicate overall reduced delays in the settlement and recovery of accountable advances. For example, 43 percent of the advances we sampled for 1993–94 were not accounted for within 10 working days after the purpose for which they were issued was fulfilled (a Treasury Board regulation). The results from a year earlier indicated that 70 percent were not accounted for within the same time period. Current changes in the Department's accounting system, procedures and monitoring have been largely responsible for these improved results.

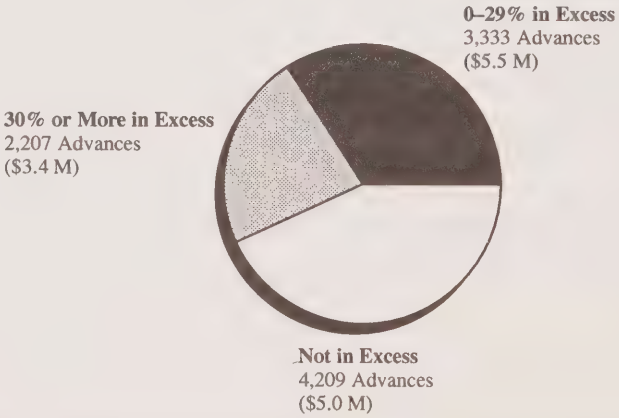
In 1992, we reported in a management letter to the Department the results of a limited review of employee travel advances. An objective of this review was to assess whether amounts of money given to employees for travel advances were reasonable. The review found that travellers were taking advances well in excess of what would have been adequate to meet their specific travel needs and that no one appeared to be questioning the amount of advance needed for a particular trip. We pointed out that the solution may ultimately lie in preventive controls, which place greater responsibility upon the traveller and his or her supervisor. The Department planned but did not implement a specific project to address this issue. The Department has pointed out that it is implementing the distribution of an internationally known credit card to headquarters employees with the intention of reducing trip advances.

We have two remaining concerns: First, many advances are still not being settled within 10 working days. A contributing factor could be the attitude of the employees. The Department may wish to make clear to employees its expectations in this regard and the seriousness with which it views the non–settlement of advances. Alternatively, the Department may wish to approach the Treasury Board with a new approach to funding international travel. For example, many organizations that operate internationally, such as the Export Development Corporation, have modernized their systems with increased computerization, use of credit cards and simplified per diem travel advances. We recognize that a final decision on this matter will involve the National Joint Council.

Second, the size of travel advances issued to employees continues frequently to exceed the amount that could reasonably have been required to cover the expenditures. A contributing factor may be that supervisors are not questioning the amount of the advances requested by subordinates. The graph below illustrates our concern in this area.

Travel Advances in 1993–94

This chart shows travel advances issued and settled that exceed the amount required to cover the expenditures that could have been reasonably expected to be made for that purpose.



Source: Financial Information System, Foreign Affairs and International Trade Canada (1993–94)

Exhibit 22.7 (continued)

B. The Department should improve accounting controls and procedures on an urgent basis in order to ensure that appropriate professional standards are achieved and maintained for the control of money advanced to employees and in all areas of financial management.

We reviewed and tested three aspects of accounting controls and procedures. The first, as discussed above, involved the management of accountable advances. The second encompassed the system for collecting monthly rents from Canada–based staff abroad (shelter shares), and the third dealt with accounting controls and procedures at the missions.

Shelter Shares

In Chapter 9 of our 1991 Report, Financial Management and Control of Non–tax Revenues , we reported that the Department was experiencing significant problems in the collection of shelter shares. The majority of cases involved shelter shares that had not been deducted from monthly foreign service allowances. The Department took special action and collected more than $850,000 in overdue rents from over 300 employees located around the world.

Improvements to the systems and procedures are in place to reduce the extent of delinquent shelter shares. In December 1993, the level was approximately $200,000, mainly due to problems in the administration of allowance deductions at headquarters. We noted that the main improvements have been at the mission level. We are encouraged that the Department is working assiduously to make comparable improvements at headquarters. However, it is too early to assess the impact of the changes being implemented. This is the case with a departmental reporting and control system that has recently been implemented at headquarters.

An underlying cause of the delinquency in the collection of shelter shares, particularly at headquarters, may be the inordinate complexity of current collection procedures. Shelter shares can be paid in cash at the mission level or through deduction from foreign service allowances at headquarters – two methods, two locations and no single focal point for accountability.

The Department may wish to re-examine the options and procedures for the payment and collection of shelter shares with a view to simplification — perhaps one method, one location. Depending upon the option selected, the involvement of the National Joint Council may be necessary. We encourage the Department to continue to emphasize to its employees that they have a personal responsibility to ensure that they pay their rent on time and with no exceptions.

Mission Controls and Procedures

In order to assess the extent of improvements in the quality of mission accounting practices, we relied heavily on the results of internal audits of missions over the past two years.

This internal audit work was augmented by our discussions with mission accounting staff in 5 of the 10 missions we visited. General improvements were noted in the effectiveness of mission accounting controls. This was particularly evident where mission administrative staff were experienced and capable and where the head of mission took an evident interest in financial management.

We comment on the recruitment and training of the mission administrative staff in a subsequent section of this exhibit.

C. The Department should ensure that effective and timely monitoring, follow–up and recovery procedures are established and maintained for all advances to employees.

The Department has established a number of procedures, as stated in section B of this exhibit, that have led to improved results. However, sustaining these improved results will require continued vigilance. The Department recognizes the importance of changing employee attitudes to support improvement in this area. Organizational changes in the financial functions are under way and performance appraisal systems are being strengthened. The full impact of these changes on the control of accountable advances to employees can be assessed only over time.

D. The Department should review the frequency of postings abroad with a view to extending postings for a longer period where possible.

In 1990, the Standing Committee on Public Accounts outlined its concern regarding the cost and administrative impact of frequent staff rotations. The Department, in its response to the Committee's concern, stated that it "shares the Committee's view of the value of longer postings for staff serving abroad and will shortly be implementing action to extend assignments."

With the exception of some limited adjustments, this action was not taken, nor was any substantive review of the frequency of postings undertaken by the Department. We urge the Department to revisit this area, in particular, the need to reduce the frequency of posting for administrative staff who may not need to "rotate" as frequently as other foreign service officers. For instance, extending the average length of postings from three to four years would lead to annual savings in relocation costs, which we estimated could be up to $5 million.

Exhibit 22.7 (continued)

E. The Department should ensure that information contained in the Public Accounts of Canada pursuant to section 38(3) of the* Financial Administration Act *is complete and accurate.

Section 38(3) of the *Financial Administration Act* states that "every accountable advance that is not repaid, accounted for or recovered by the end of the fiscal year in which it was made shall be reported in the Public Accounts for that year."

As part of this audit we reviewed a sample of advances for fiscal years 1992–93 and 1993–94. Outstanding accountable advances reported by the Department in the 1992–93 Public Accounts were materially understated. The table below indicates that the Department reported an amount of $96,000 in advances unaccounted for at 30 April 1993. Based on our audit work, our best estimate is that an amount of at least $2.3 million should have been disclosed to that date. We have advised the Department to restate prior year figures in the Public Accounts so that the correct position is reflected in the 1993–94 Public Accounts. On 15 September 1994, the Department so advised Public Works and Government Services Canada, which is responsible for preparation of the Public Accounts of Canada.

Accountable Advances 1992–93 Public Accounts of Canada

Information on outstanding accountable advances reported by the Department in the 1992–93 Public Accounts of Canada was materially understated.

		31 March 1993	30 April 1993
Reported by the Department	**1.**	$2,742,476	$96,098
What should have been reported	**2.**	$7, 549,543	$2,277,148

Note: The amount reported for 30 April reflects accountable advances that were outstanding at 31 March (the end of the government's reporting period) and were still not settled one month later.

Source : 1. 1992–93 Public Accounts of Canada, Volume II, Part II, Accountable Advances.
2. Estimate made by the Office of the Auditor General of Canada

Recent changes in the Department's accounting system, procedures and monitoring have reduced the time taken to account for accountable advances. These changes have led to more complete and accurate reporting of accountable advances in the 1993–94 Public Accounts of Canada. However, the Department has stated in the 1993–94 Public Accounts of Canada that "because of the worldwide diversity of this Department's operations, included in this figure are accountable advances deemed outstanding for overall reporting purposes but individually are in doubt because of employees' assertions that they have settled. These cases may involve accounting errors by missions, missing/lost claims and claims in transit. Also included are cases where recovery action has already been initiated."

Other financial items of continuing interest

Two of the several factors contributing to the serious accounting control inadequacies of the Department (discussed in the *Ninth Report* of the Standing Committee on Public Accounts) were related to the lack of a single computer–based accounting system at missions and inadequate recruitment and training of fully qualified financial officers. These two areas, although not explicitly stated as recommendations in the *Ninth Report*, have been a matter of continuing interest to the Standing Committee on Public Accounts. We therefore provide commentary on these matters:

Recruitment and Training

The Department has undertaken a series of initiatives to increase the overall competence of its financial and administrative officers both in headquarters and abroad. The following actions reflect that effort:

- In the early 1990s, the Department reorganized its financial operations in headquarters and recruited qualified financial officers to staff them.
- The Department's Finance Division has stepped up its financial training for administrative staff in Ottawa and in the missions.
- In late 1992, the Department introduced a mission administrative officer training program for new recruits. About 20 of these trained recruits now occupy administrative positions abroad. (There are 125 positions.)

Exhibit 22.7 (continued)

That said, the majority of Canada–based and locally engaged staff in the missions have not had access to the type of training currently being offered to new recruits. A recent departmental review of the training needs of Canada–based administrative staff indicates the need for further improvements. Such training is particularly important because missions are expected to acquire further delegation of authority, and advances in information technology are changing mission administrative procedures continually. The Department is developing a training program to meet the needs of Canada–based administrative staff.

About 60 of the current 125 mission administrative officer positions are filled by staff whose classifications and levels are lower than the job requires. About half of these employees have not had adequate recent training. Mission administrative officers interviewed during our visits to the missions indicated that employees placed in such situations abroad may have difficulty ensuring that financial controls are implemented.

Systems Integration

In 1991, the Department informed the Standing Committee on Public Accounts of its plan to implement mission FINEX (a smaller version of the computer–based financial system used at headquarters) in missions abroad and to integrate this system with SIGNET (the Department–wide computerized message system), which was being installed in several missions.

The Department has substantively met its goals in this regard. Further developments in the application of information technology and training of administrative staff are essential to realize the full benefits of these systems.

22.58 In our 1993 Report (Chapter 6, "Canada's Public Service Reform and Lessons Learned from Selected Jurisdictions") we indicated that "an important theme of Public Service 2000 is the increased delegation of authority from central agencies to departments and, within departments, to the lowest levels reasonable."

22.59 Comptrollership is as much a way of thinking and a concern for public assets and expenditures (on the part of all employees and not just financial officers) as it is a set of approved management expectations and techniques. While the senior financial officer is usually assigned the task of developing and maintaining comptrollership in organizations and often holds the title of "comptroller", the responsibility for managerial risk clearly rests with the managers making the decisions.

22.60 The deputy heads and managers at all levels in the Department are responsible for ensuring that there is sound comptrollership in their respective responsibility centres. Comptrollership is not an option. It is essential to achieving objectives and meeting the fiduciary responsibilities entrusted by Parliament.

The Department has taken steps to strengthen comptrollership

22.61 The Department has taken steps in several areas to improve financial management practices across the organization. For example, the Canadian Foreign Service Institute was established in 1992 to provide continuing education in a variety of areas, including financial management and control. The Institute's Heads of Mission Pre–departure Program is now in its second year. Approximately 60 newly appointed heads of mission have taken part in this program of participative learning and discussion, which focusses on their responsibilities abroad, typical problems at the mission (many in the areas of finance and administration) and government priorities.

Comptrollership is not an option.

22.62 Mission comptrollership also requires qualified and capable mission administrative officers. The Department has undertaken an initiative to improve the calibre of these officers abroad through enhanced recruitment and training programs.

22.63 Another of these initiatives, and perhaps the most visible, has been the internal audit of missions. More than 200 audits have been conducted in the past two years. Besides identifying specific areas for improvement, these audits sent a clear and repeated message worldwide that financial administration and control in the Department must be strengthened.

Cost awareness is becoming more prevalent throughout the Department.

22.64 Cost awareness is becoming more prevalent throughout the Department. The Corporate Services Branch has recently undertaken initiatives to better understand the full costs of providing many of its services as well as the factors impacting on these costs. This work could be the first step toward reinforcing a sense of comptrollership at the corporate level. For example, the full costs of delivering programs and activities abroad in each mission could be provided to heads of mission, thus reinforcing current efforts to strengthen the performance review process and, ultimately, the accountability of heads of mission for measurable results. In addition, the costs of other government departments in missions abroad could be charged out to these departments. This could enhance accountability, transparency and, possibly, efficiency. We recognize that this would entail some increase in administration costs.

22.65 Until recently, the Department did not identify and report the cost of providing services abroad to other government departments. By early 1994, however, the Department had developed a costing model that has the potential to attribute the costs of various activities. Once the Department has more accurate ongoing information on the cost of its own activities, it will be in a better position to assess their costs and benefits.

22.66 The development of this costing model is a significant first step in establishing a full–cost mindset within the Department. In one of its first applications, the model was used to identify the forecasted costs of operations abroad for 1993–94. The results were then used in negotiating with other government departments their shares of the Department's budget reduction for 1994–95 and future years. Based on feedback from the Treasury Board Secretariat and other government departments, the Department believes that development of the costing model has satisfactorily met the objective of its first application.

22.67 Further steps will be required to ensure that full costing information is obtained for proper disclosure and decision making. For example, the cost allocated to operations abroad did not take account of some program delivery costs at headquarters, such as finance and administration. The allocation of all overhead costs could represent an additional $40 million to $100 million in services provided to other government departments. These services are currently estimated at $176 million for 1993–94. The Department advises us that it remains committed to extending the model to encompass the entire departmental budget. It also intends to convert the model to a data base format to enhance its accuracy and utility for program analysis, planning and reporting.

22.68 Headquarters has also improved accounting controls in areas such as the collection and recovery of accountable advances and shelter shares. Over the last few years, the Department has implemented an on–line worldwide financial information system (FINEX). Its evolution from a financial accounting information system to a fully integrated financial management information system is beginning. This advance could provide

improved and more timely information to support effective financial decision making.

22.69 Headquarters has completed a study to reduce the reporting requirements that have particularly burdened small missions abroad. This study has identified many reports that are no longer required or can be simplified. The Department is currently acting on these findings. For example, of the current 121 reports being completed by missions, 12 have been eliminated for all missions and a further 13 have been eliminated and 16 simplified for small missions.

Some factors that impact upon comptrollership

22.70 Departmental officials point to just how little of their budget they can directly influence to control future cost increases. For example, they indicate that the level of support services to other government departments, the amount of peacekeeping and other contributions, and the cost of membership in international organizations are not within their discretionary authority. Decisions on the level of such expenditures, which represent some $550 million out of the Department's $1,420 million budget for 1994–95, are taken at the political level. In our view, while this may well be true, the need to manage funds with due regard to prudence, probity and value for money remains with the Department. Chapter 21 of this Report, which deals with the management of contributions for technical assistance provided to Eastern Europe and the former Soviet Union, illustrates this view.

22.71 The Department has also stated that the increase in its operating expenditures due to foreign price inflation and changes in the value of the Canadian dollar is another area outside its direct control. In our view, the Department has the ability to reassess the size of its operations in high-cost, high-inflation countries and to make appropriate adjustments.

22.72 Traditionally, foreign service operations have emphasized skills related to the development of foreign policy as opposed to those related to financial management. In the last few years, fiscal restraints, advances in information technology and a higher priority placed on measurable results have shifted this emphasis. Today, it is necessary to reinforce not only good policy development but also good management skills. The Department has introduced an individual performance appraisal system that reflects the new emphasis on management skills.

Departmental officials point to just how little of their budget they can directly influence.

22.73 Recent changes in priorities will require strengthened comptrollership. The Department has moved to strengthen this function through the establishment of its Program Management Board, a committee of deputy ministers and the Assistant Deputy Minister, Corporate Management that approves all expenditures over $100,000 after consideration of policy and resource management issues.

Today, it is necessary to reinforce not only good policy development but also good management skills.

22.74 The Department believes that Treasury Board is still heavily involved in micro–managing the Department's activities. Our review of 48 of 50 submissions made by the Department to Treasury Board during 1993–94 revealed a number of instances that support this view. For example, submissions had to be made for such straightforward expenditures as contracting for cleaning services in Tokyo, renting hotel rooms in Vancouver, and reimbursing the salary of a person from the private sector on interchange to the Department. This perpetuates a sense of micro–management from outside the

Department. A results–oriented mindset is difficult to achieve in this environment.

Need for a stronger sense of comptrollership at missions

22.75 Comptrollership must become an essential value for each manager, including the head of mission. In a foreign service context, this implies acceptance of the need for flexibility to adjust operating procedures to local conditions. Since Canada–based managers and staff change posts regularly every two to four years, a common set of values would ensure continuity when new staff are posted.

22.76 Comptrollership at the missions is being improved. The following are some ways in which it can be further strengthened:

Comptrollership must become an essential value for each manager, including the head of mission.

- First, a results orientation needs to be institutionalized. Mission objectives do not clearly define expected outputs, outcomes or accomplishment in any measurable way against the costs incurred.

- Second, there is a need for more cost awareness. The heads of mission do not know the full costs of running their missions. Many costs incurred at headquarters for the missions are not reflected in mission budgets. An example of this is the allocation of overhead costs from headquarters. These items represent a major proportion of the costs of running a mission. Recognizing this, the Department is further developing its costing model and is upgrading its financial system (FINEX) to provide this information to departmental management.

- Third, responsibility to control costs needs to be matched with authority. Heads of mission have indicated to us that they have limited say in many of the decisions associated with the programs of other government departments that they are expected to supervise. If key decisions relating to other government departments abroad are the responsibility of their managers, what is the head of mission expected to supervise?

- Fourth, some heads of mission need to set a better example to staff. The Department's Office of the Inspector General has pointed to the continued need for heads of mission to demonstrate leadership and interest in financial management and to set an example to staff concerning proper spending values and ethics.

- Fifth, mission administrative officers and their staff need to have the stature, knowledge and experience required to ensure that employees are following appropriate standards of prudence and probity. To improve their effectiveness, the Department will convert mission administrative officers to foreign service officers as part of a larger initiative to restructure the foreign service classification system.

22.77 The head of mission and the mission administrative officer must act as a team to ensure effective comptrollership. Simultaneous transfers of the head of mission and the mission administrative officer can greatly disrupt the smooth running of mission operations. At one large and growing mission in a developing country, the Department transferred the head of mission and mission administrative officer simultaneously during the summer of 1994— perhaps there should have been as much as one year overlap. To our knowledge, there is no formal departmental policy that addresses this issue.

Alternative approaches for future consideration

22.78 A fundamental aspect of comptrollership in any organization is appropriate attitudes and behaviour on the part of its human resources. An organizational culture that reinforces concern for public funds and appreciation

of the full costs of decisions is essential. We believe the Department should strengthen comptrollership through increased cost awareness in all areas of its operations.

22.79 During this audit, we were able to identify some key factors that affect cost awareness at all levels in the Department (Exhibit 22.8). The Department may wish to examine and address these factors.

22.80 The Department is encouraging its heads of mission to seek out useful ideas that are emerging in other foreign ministries. The government may also wish to look to other governments for ideas on how to improve comptrollership. A start could be made by examining some approaches adopted in Australia and New Zealand.

22.81 Australian experience. As part of its Financial Management Improvement Program, the Australian government introduced the principle of "devolution" — allowing managers more flexibility in managing their resources to achieve stated government objectives. Devolution was achieved through a less centralized structure and through greater emphasis on accountability to ministers, Parliament and the public for program performance. Further, the appropriation rules were changed so that, once administrative expenses were approved by Parliament, funds could be managed flexibly by departments according to approved priorities. For instance, Australian heads of mission have the authority and flexibility to roll over funds to, and to borrow funds from, the next year's operating budget. This gives heads of mission more opportunity to run their missions in a businesslike manner.

22.82 New Zealand experience. Similarly, changes to the New Zealand *Public Finance Act* have given more autonomy to the operating units of the Ministry of Foreign Affairs. The Ministry exercises wide discretion over how funds allocated to it will be spent, provided results are costed and measured. Managers under this system have a clear sense of responsibility as well as the financial resources to meet performance expectations. Stated performance deliverables and desired government outcomes eliminate doubt about what anyone should or should not be doing. The Ministry evaluates its posts twice a year, placing particular emphasis on the performance of heads of mission as it relates to the cost of meeting specific mission objectives.

22.83 In summary, the need to strengthen comptrollership warrants continued attention.

Property Management

Background

22.84 The Department estimates that the value of its Crown–owned property worldwide was between $2 billion and $3 billion in 1992–93. The annual rent, including taxes paid for Crown–leased properties abroad, was estimated at $133 million.

The Department estimates that the value of its Crown–owned property worldwide was between $2 billion and $3 billion in 1992–93.

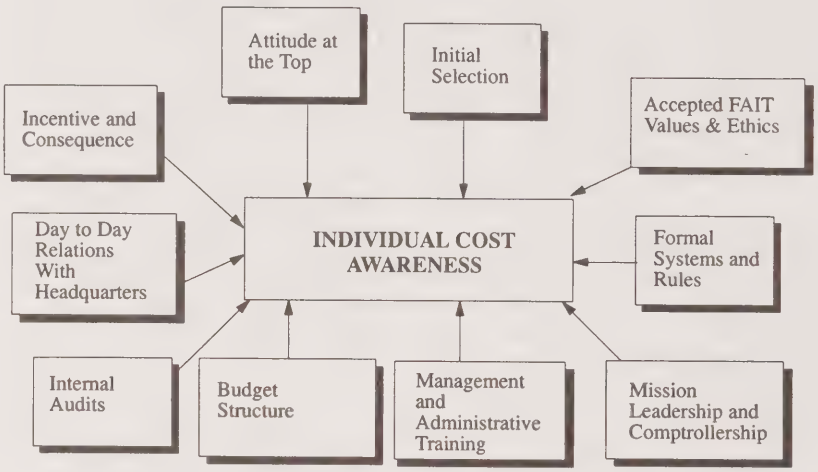
22.85 The Department provides office and residential accommodation to its employees and to employees of other government departments who are posted abroad. The Physical Resources Bureau, an organizational unit within the Department, manages these properties on the Department's behalf.

22.86 The Director General of the Bureau reports to the Assistant Deputy Minister, Corporate Management, who is accountable for major property decisions. The Bureau is responsible for strategic property planning, analysis and reporting and for liaison with Treasury Board, other

Exhibit 22.8

Some Factors Affecting Cost Awareness at Foreign Affairs and International Trade Canada

This chart depicts some of the key factors that affect cost awareness at all levels in the Department.



Source: Prepared by the Office of the Auditor General of Canada

1. **The attitude at the top** of any organization is critical to changing employee behaviour. This Department is no different. The degree to which its deputy ministers and assistant deputy ministers live up to the stated value of cost awareness will determine in large measure its ultimate acceptance.

2. **Staff selection** procedures can help ensure that new recruits have a concern for expenditures. The degree to which that concern is built into the screening and debriefing process for future managers and officers is the first step to sustainable cost awareness. While the Department has taken care to select intelligent individuals of high integrity, it could do more to emphasize cost awareness in the foreign service as a priority and an expectation.

3. **Accepted departmental values and ethics** can send a clear message to all staff that cost awareness is important. The Department's Code of Conduct and Conflict of Interest Policy has been buried in the Human Resource Management manual. The Department has recognized the importance of making these values and expectations more visible. Staff debriefings before employees go abroad, individual messages from headquarters to all staff and the distribution of the Treasury Board booklet on Conflict of Interest to all employees show that the Department is acting on this recognition.

4. **The formal systems and rules** that currently apply to the Department also influence the value placed on cost awareness. For instance, foreign service allowances are based on consistent equitable entitlement: economy has not been a primary consideration. Comparability with similar housing available in Ottawa governs the selection of accommodation abroad for employees. Employees we interviewed expressed frustration with attempting to behave in a cost–conscious manner when confronted with inflexible directives and guidelines of this nature.

5. **Mission leadership and comptrollership** are also necessary to reinforce employee's cost awareness. The head of mission has to lead by example, and mission administrative staff have to provide the control and follow–up necessary to ensure that cost awareness is an operational reality in missions. Our audit work, as well as internal audits, indicate that improvements have begun in this area.

6. **Management and administrative training** of administrative staff and heads of mission is also important. The Department has recognized this and has taken steps to enhance training in these areas. However, we believe that more needs to be done to make heads of mission more aware of the fundamentals of financial management and control.

7. The Department's **budget structure** plays a significant role in reinforcing managerial cost awareness. However, current problems in developing full–cost data for specific activities constrain the ability of managers to make fully informed and reasonable decisions.

Exhibit 22.8 (continued)

8. **Internal audits** of missions have elevated the importance of cost awareness even though their primary focus has been on compliance with financial administration regulations. These audits would have to continue indefinitely in order to sustain their impact on individual cost consciousness.

9. **Day–to–day relations with headquarters** have influenced individual cost awareness in the missions. Our visits to the missions revealed staff concerns regarding administrative reporting requirements from headquarters. We also observed dissatisfaction with how headquarters deals with mission staff in day–to–day communications, particularly in the area of accountable advances. Both of these factors have dampened employee enthusiasm for cost–awareness behaviour.

10. **Incentives and consequences** are perhaps the most effective ways of influencing individual cost awareness. We noted during our audit the limited opportunity that exists to provide tangible incentives to departmental managers and employees for positive results and behaviour. For instance, we found some year–end property renovation projects in progress that might not have been carried out if the opportunity had existed to transfer the unused portion of the mission property maintenance budget to the next fiscal year. Individual performance reviews, based on clearly stated expectations and the incentives and consequences for meeting or not meeting these expectations, can reinforce cost–awareness attitudes and behaviour. The Department is implementing a new approach to performance review that will provide this reinforcement.

government departments and the private sector on property matters. The Bureau also manages the Long–Term Capital Program, the buying/leasing of chanceries and official residences, major property renovations and the property requirements of other government departments.

22.87 Several other key stakeholders work with the Bureau to effect property decisions abroad. Geographic branches identify property needs, provide assistance and input to the Bureau, and manage properties abroad; that is, they manage the leasing of staff quarters, payment of rents for leased properties and routine maintenance. They, in turn, delegate appropriate authority to the heads of mission. Heads of mission play a key role in identifying their property needs and in providing the data on local property for input to the Bureau's worldwide property information system. Other government departments identify their property needs abroad and work with the Bureau to fulfil those needs.

22.88 Decision making with respect to major capital expenditures is shared among the Physical Resources Bureau, the geographic branches and the missions. Property needs are identified and agreed on by these stakeholders, then integrated into the Long–Term Capital Program. The Program is approved annually by the Departmental Program Management Board.

22.89 The departmental property–related capital and operating expenditures for 1988–89 and 1993–94 are presented in Exhibit 22.9. Over this five–year period, expenditures rose 20 percent. However, there were significant decreases as well as increases during this period.

Progress since 1987

22.90 In 1987, we reported that roles and responsibilities for budgeting and monitoring overall departmental accommodation costs and for ensuring that accommodation standards were adhered to should be better defined. Ill–defined roles and responsibilities had resulted in weaknesses in the accommodation planning process, ad hoc monitoring of the costs of staff quarters and their adherence to standards, and delays in issuing guidelines to missions.

22.91 We therefore recommended that the Department:

- clearly define and communicate roles and responsibilities for planning and monitoring accommodation;

- further improve its accommodation planning process by ensuring that inputs to the Long–Term Capital Program result from a systematic review of current holdings, accommodation needs and costs; and

- seek from Treasury Board a higher limit on its authority to acquire property, as well as authority to use disposal proceeds when acquiring property to be used for the same purpose.

22.92 We reported in our 1989 follow–up to this audit that departmental progress to address these recommendations had been slow. We also noted that the management of property abroad was still reactive; that is, accommodation planning remained inadequate.

The objective is to allow the Bureau to operate in a more business–like manner.

22.93 Following the appointment of a new director general for the Bureau in 1992, a number of initiatives were undertaken to improve cost–effective management of properties worldwide. These included:

- clarification of roles and responsibilities relative to property management;

- reorganization of the Bureau along its main lines of business — strategic property planning, project implementation and services to missions;

- enhancement of a project delivery system;

- improved communication between the Bureau and the geographic branches;

- in collaboration with missions. introduction of a property management plan for each mission;

- significant changes to property management information systems;

- the use of different approaches to financing property transactions; and

- development of a human resource and training plan for Bureau staff.

Physical Resources Bureau designated as a special operating agency

22.94 In early 1993, the Department sought and obtained Treasury Board approval (effective 1 July 1993) to transform the Bureau into a special operating agency. The objective is to allow the Bureau to operate in a more businesslike manner. The Bureau is expected to simplify and modernize its methods with a view to reducing costs and providing cost–effective accommodation and facilities.

22.95 The Treasury Board approval includes, among others, two key features. It gives the Bureau authority, in principle,

Exhibit 22.9

Property–Related Capital and Operating Expenditures in 1988–89 and 1993–94 ($ millions)

	1988–89	1993–94
Capital Expenditures	54.0	35.0
Operating Expenditures:		
– Rent	80.0	106.0
– Maintenance and Utilities	29.0	40.0
– All Other Operating	12.0	28.0
Total Operating Expenditures	121.0	174.0
Total Expenditures	175.0	209.0

Source: Supply and Services Report # 9005 (1988–89); Supply and Services Report # 259 (1993–94)

to retain and reinvest revenues generated through property disposals, rentals and sublets. However, full authority to spend in future years revenues generated in the current year was not provided. The approval also allows for a transitional approach in which the Bureau will progress toward full empowerment as a special operating agency within the Department over a period of 20 months. In our view, these two features will directly enhance the Bureau's ability to manage properties in a cost–effective manner.

22.96 The Treasury Board Secretariat shares the view that the reinvestment of proceeds from the sale of surplus property is essential to strategic property management. However, given the current commitment to deficit reduction and spending controls, it requires that the Department contribute a portion of the net proceeds from the sale of properties to meet this commitment. The challenge facing the Department and the Secretariat is to adequately contribute to this commitment while reinvesting sufficient revenues to enable the Department to meet accommodation requirements abroad in a businesslike manner.

22.97 Further, Treasury Board approved, in principle, the transitional business plan for 1993–94 and 1994–95. However, the Treasury Board decision imposed some important limitations: the Department will not be entitled to 100 percent of sale proceeds but to a percentage determined each year based on government–wide affordability considerations; and this percentage of sale proceeds can generally be accessed late in the fiscal year through supplementary estimates. This restricts the availability of both time and funds. If permanent, the limitation could hinder the ability of the Bureau to make cost–effective property decisions.

The Bureau is developing a capacity to function as a special operating agency

22.98 We believe that effective property management requires, among other things, an organization structured and staffed to deliver services effectively; relevant and quantifiable performance goals that measure cost effectiveness; and access to complete, accurate and timely information for property management.

22.99 The Bureau has addressed these requirements. For example, the Bureau is completing a reorganization of its operations along its main lines of business. However, there is more work to be done.

22.100 Bureau management recognizes the value of highly trained staff in achieving its objectives and has indicated that training initiatives are planned in the following areas:

Bureau management recognizes the value of highly trained staff in achieving its objectives.

- additional training for portfolio managers in investment management and analysis techniques;
- more training for project officers in project management; and
- expanded training for staff responsible for mission support services (for example, procurement, maintenance and shipping) in order to ensure a more client–focussed approach to the provision of these services.

22.101 Bureau management has informed us that some performance targets to measure cost effectiveness are already established in general terms. Targets include:

- holding the base Long–Term Capital Program appropriations at $31 million for future years (as opposed to the previous five–year average of $43 million);

- financing the current and future Long–Term Capital Program expenditures of over $300 million through three principal methods: appropriations of $155 million; proceeds from property sales and rentals; and new financial arrangements involving the leveraging of private sector funding; and

- reducing the leasing costs that are being incurred at present.

22.102 We believe that other quantifiable indicators also need to be considered to measure success and illustrate progress toward more businesslike property management. For example, the cost of accommodation per employee abroad and the cost per square metre of office space provided are the kinds of indicators that could be used.

Significant savings could be realized in four specific areas: property disposals, underutilized properties, leasing costs and representational housing.

22.103 All property management information systems were recently reviewed for the Department by an informatics consultant who concluded, among other things, that:

- a comprehensive information management plan should be developed;

- the quality and timeliness of information needs to be improved; and

- as yet, not all current information technology meets SIGNET standards.

22.104 Bureau management agreed with the thrust of the consultant's report and has set up a task force to implement its recommendations. Specific deliverables have been identified for both the short–term and long–term informatics plans.

Significant opportunities exist to achieve savings

22.105 Significant savings could be realized in four specific areas: property disposals, underutilized properties, leasing costs and representational housing.

22.106 Property disposals. The Bureau has identified within its Long–Term Capital Program several oversized or underutilized properties worth approximately $146 million. Two recent events that illustrate the current availability of properties for disposal are the centralization of CIDA and the rationalization of immigration offices from numerous missions to one regional mission site.

22.107 Government decisions to close certain missions, as well as specific disposals directed by Treasury Board, are also cited as reasons for selling properties. These factors have changed departmental accommodation requirements in several locations abroad.

22.108 Our concern is the length of time it will take to generate savings. Property disposals can be complex and lengthy because of market conditions abroad. Properties are located all around the world but the disposal decisions are made in Ottawa. This accounts for some delay. For example, appropriate property appraisals in certain countries are difficult to obtain and approval by the Department of Justice is required to retain legal firms abroad. Moreover, unless the Department can be assured of capital funding to replace certain high–cost properties, delays in the disposal of those properties will result. In the past, the disposal of some properties has been quite slow. For example, several properties in Port of Spain, Canberra and Dar–es–Salaam that were approved for sale in 1989, 1990 and 1991 were not sold until the middle of 1994. In 1994–95, 26 properties were sold for $14 million. Almost all properties were identified for sale after January 1993, indicating that property sales are proceeding quite quickly. Notwithstanding this, the Department

continues to pursue improvements in this area.

22.109 Underutilized properties. As organizations evolve, requirements change. The Department has bought properties around the world over several decades. Some of these properties have appreciated substantially during this time and are not being used to their best market potential. The Bureau has identified properties, including official residences with substantial equity, in Brasilia, Kuala Lumpur, New Delhi and Tokyo that could be put to better use. We encourage the Department to actively pursue the opportunity for savings at such locations.

22.110 Lease costs. There is also a potential for reducing property lease costs worldwide. One way to accomplish this is by purchasing and building accommodation. Bureau management has indicated that this will reduce leasing costs; reductions are expected to be $2.3 million in 1994–95 and progress to $11 million in 1998–99. It should, however, be noted that there are significant offsetting costs attached to ownership such as interest, depreciation and maintenance. These should be taken into account in any calculation of net savings that might result. Other ways include reducing leased space and renegotiating leases where the market is favourable for reduced rents (this would save approximately $1 million a year); and leasing out vacant office space to reduce costs by $650,000 a year. Effective 1 October 1993, the Canadian mission in Jakarta reduced its office space by 16 percent when CIDA's operations were centralized. This saved about $118,000 in annual rent. Similar opportunities exist in Bangkok, Lagos and Lusaka.

22.111 Representational housing. Representational housing refers to the space allocated in staff quarters abroad for official hospitality. A representational house is generally larger and more expensive than other staff houses. In early 1994, the Department changed its eligibility criteria for representational housing. Initial feedback from the missions indicates that this change will represent significant future savings.

22.112 In summary, we believe that increased flexibility to reinvest proceeds from sales is essential for the Bureau's success. However, the Bureau needs to demonstrate its commitment to realizing financial savings by setting and meeting quantifiable performance targets for which it can be held accountable, and by completing its reorganizing and training efforts.

Foreign Service Directives

Background

22.113 Foreign service directives (FSDs) describe the supplementary compensation and conditions of employment applicable to employees serving abroad. They took their form as directives after 1969 following an intensive study by Treasury Board Secretariat and departmental officials of the particular needs of foreign service employees. Prior to 1969, compensation was provided through a series of allowances dating back to 1907, which were formalized into the Foreign Service Regulations in 1962.

22.114 In combination with salary, the foreign service directives attempt to ensure that qualified persons are recruited and retained to serve abroad effectively. Variations in conditions of employment abroad are compensated for to the extent possible. Conditions for the application of the directives are defined in the text of the FSDs, issued by the Treasury Board Secretariat and administered by the Department, both for departmental

employees and for certain other public servants abroad.

22.115 The directives are based on three principles:

1) The **comparability principle** recognizes that employees serving abroad should be able to maintain a standard of living that is neither less nor more favourable than that in Canada. They should have access, for example, to comparable shelter, education of dependants and health care.

2) The **incentive–inducement principle** recognizes the importance of providing additional allowances to attract employees to serve outside Canada. There are four provisions: foreign service premium, post differential allowance, foreign service leave option, and foreign service travel assistance.

3) The **program–related principle** attempts to ensure that employees abroad are provided with the means to carry out the programs assigned to them; for example, they are relocated at employer expense.

22.116 In 1987, we reported on our concerns that the Department should examine ways to simplify the FSDs and make them easier to apply. The Department responded that efforts were being made to simplify the directives. We also expressed concern over the Department's monitoring of their costs and compliance with conditions. We recommended that the Department compare actual costs with estimates and improve procedures for monitoring. The Department agreed.

22.117 We also questioned the procedures for determining whether the FSDs achieved their stated intent and recommended that the Treasury Board Secretariat regularly evaluate and report the extent to which the directives do so.

22.118 In 1989, we reported that progress in implementing our recommendations had been slow. The Department responded that there had been delays in comparing actual costs with estimates. We also noted that simplification of the directives was viewed by the Deputy Minister as a matter requiring serious attention.

Progress since 1989

22.119 The Department has undertaken several initiatives to address our concerns. By 1989, it had already begun working as part of a steering committee to review individual directives. A number of recommendations were made for joint employer–employee consideration. Some of the proposals put forward were included in the 1993 revision of the directives, for example, the use of non–accountable advances.

22.120 At the same time, the Department, with the committee, examined options to simplify the existing FSD system. The committee made several proposals but there was little action.

22.121 The Department has prepared and distributed a Foreign Service Handbook to help employees and mission administrative staff use the FSDs. It is currently reorganizing its personnel and finance divisions to streamline administration and is examining ways to automate the directives to make them more user–friendly.

22.122 Among its other initiatives, the Department has begun keeping a record of interpretations of the directives for future reference. It is also offering a course at the Canadian Foreign Service Institute on the application of FSDs and is

contributing to a more active interdepartmental working group on their administration.

22.123 We regard these efforts by the Department as positive and commendable. However, our long–standing concern regarding the complexity of the foreign service directives has not been fully resolved. Perhaps one indicator of the complexity of the directives is their size. Prior to becoming directives negotiated with employee representatives, the 1967 Foreign Service Regulations consisted of about 100 pages. Today, the FSD text is more than 450 pages.

The foreign service directives remain complex

22.124 The Department and the Treasury Board have been unable to address the complexity of the foreign service directives. The number of stakeholders involved and the complexity of the process to effect change have hindered progress toward achieving this goal.

22.125 The Department cannot act unilaterally. Other departments and agencies have a stake in the directives. These stakeholders include the Treasury Board, the Treasury Board Secretariat and employee representatives at the National Joint Council, the Department of National Defence, the Royal Canadian Mounted Police, the Canadian International Development Agency and the Department of Citizenship and Immigration.

22.126 Who can effect change to the Directives? The Treasury Board, as the employer, is ultimately responsible for the directives under the *Financial Administration Act*. Since 1967, with the onset of collective bargaining in the Public Service, compensation for serving abroad has evolved from a consultation process to a negotiation process in the National Joint Council akin to collective bargaining, but with some differences. For example, tentative agreements reached by the Treasury Board Secretariat and employee representatives do not have to be ratified by the bargaining agents' membership. The Council provides a forum where management and employees, represented by their bargaining agents, can discuss proposed changes and reach agreement on the content of the FSDs.

22.127 Every three years, the directives are reviewed and the levels of various allowances and benefits are adjusted. When agreement is reached, changes are incorporated into the FSD text and are binding on both parties. The President of the Treasury Board has the authority to approve changes to the FSDs on the recommendation of the National Joint Council.

Our long–standing concern regarding the complexity of the foreign service directives has not been fully resolved.

22.128 It is interesting to note that other governments and private sector firms that we surveyed use a different approach to determining benefits for employees abroad. We observed that it is a common practice to seek employee input on allowances, but these consultations do not result in binding agreements like the FSDs. For instance, if economy becomes a priority, the employer retains the flexibility to make changes to the level of allowances if circumstances warrant.

22.129 The quality of financial information used for the negotiation process could be strengthened. As well, there needs to be greater assurance that management is negotiating from a value–for–money perspective. This assurance is particularly important to protect the integrity of a process that requires the participation of rotational individuals, among others, in determining the employer's negotiating position. While rotational employees can bring a necessary practical view to the

The quality of financial information used for the negotiation process could be strengthened.

negotiation, the fact that they may anticipate further posting abroad could invite the perception that they are too close to the package under negotiation.

22.130 The Department is required to interpret and apply the directives. It has little discretion on FSD payments. In this sense, the Department plays a custodial as opposed to a comptrollership role. Much of the total cost of FSDs is based on predetermined calculations that leave little opportunity for either interpretation or cost reduction. Application of the directives is based on conditions that an employee either does or does not meet and it is the Department's responsibility to ensure that these conditions are complied with.

Expenditures associated with the foreign service directives are rising

22.131 In our view, concerns over the complexity and costs of the directives need to be addressed. The costs associated with providing compensation to employees abroad are rising without proper review. A proper review would enable the employer to know of all costs, cost trends and factors influencing those costs and trends.

22.132 The Department of Foreign Affairs and International Trade has been given the parliamentary appropriation for compensation under the foreign service directives to Canada–based staff abroad who are administered by the Department. Exhibit 22.10 shows the costs to the Department of providing compensation for serving abroad.

22.133 In 1988–89, compensation expenditures of $112 million were incurred for 2,087 Canada–based staff abroad at an average cost of $53,666 per person. Five years later, in 1993–94, expenditures of $145 million were incurred for 1,764 personnel abroad, or $82,200 per Canada–based staff on average. We estimate that this amount, plus about $7 million in administration costs, brings the full cost to $152 million.

22.134 The Department's expenditures related to foreign service directives have been rising annually by an average of 9 percent per employee since 1988–89. The Department has had to compensate for significant expenditure increases in several directives, as shown in Exhibit 22.11.

22.135 An examination of individual directives shows significant expenditure increases for post differential allowances (hardship), education of dependants, travel assistance and the leave option. These four areas alone account for $9.4 million of the $12 million increase in allowance and benefit costs since 1988. This $12 million represents 36 percent of the total increase of approximately $33 million in FSD expenditures.

22.136 The net cost of shelter–related provisions has risen $15 million since 1988. This represents 45 percent of the total increase of $33 million.

Several factors contribute to the increases in expenditures related to foreign service directives

22.137 The cost of compensating employees for serving abroad can vary

The Department's expenditures related to foreign service directives have been rising annually by an average of 9 percent per employee since 1988–89.

Exhibit 22.10

Full Cost of Providing Compensation for Serving Abroad in 1993–94 ($ 000s)

Allowances and Benefits	61,500
Relocation and Real Estate Fees	31,000
Shelter	70,000
Direct expenditures	162,500
less Revenues	18,000
Total Direct Costs (1993–94)	**144,500**
Administration and other costs	7,500
Total Costs (1993–94)	**152,000**

Source: Supply and Services Report #9005 (1993–94)

with such factors as time abroad, family size and salary. As the profile of Canada–based staff changes abroad, so will the cost of these allowances. It appears from the limited data available to us that more senior than junior staff are filling positions abroad, which would increase costs.

22.138 Certain foreign service allowances increase automatically. Every April, the rates for the foreign service premium, salary equalization allowance and post differential allowance are adjusted with the average annual salary rise in the public service. Although salaries have been frozen, some negotiated pay raises have remained in various collective agreements. The Treasury Board Secretariat informed us that, as a result, the average public service salary has increased each year. The last of these raises was applied to several trades classifications in September 1993, for example, in the Ship Repair Group. This change raised FSD rates by almost two percent in 1993 and one percent in 1994.

22.139 Also, the triennial reviews at the National Joint Council of the FSDs (and other directives negotiated at the Council) have been interpreted to be outside the limitations and freezes on public sector collective bargaining for salaries. Therefore, despite the fact that salaries are capped, the review provides an avenue for increasing some allowances.

22.140 The directives are best defined as negotiated entitlements that supplement salary while abroad. The system offers little incentive for less costly expenditures or trade–offs resulting in savings to the taxpayer. In fact, as our exhibit on factors affecting cost awareness (Exhibit 22.8) indicates, there is little flexibility to treat FSDs in a cost–conscious manner.

The system offers little incentive for less costly expenditures or trade–offs resulting in savings to the taxpayer.

22.141 In summary, the Department's efforts to improve administration of the directives are noteworthy. However, our long–standing concerns remain: complexity, cost control and whether the FSDs achieve their stated intent. Effecting change in these areas would require a fundamental re-examination by the government of the FSD system, how it is managed and the controls in place to ensure value for money.

22.142 Recently, the Department has investigated fraudulent travel claims submitted by some employees under these directives. We are following up on the actions that the Department is taking to rectify this problem and the disciplinary measures taken. We will report our findings in May 1995.

	1988–89	1993–94	Increase
Education of Dependents	7,000	10,000	3,000
Travel Assistance and Leave Option	8,000	12,100	4,100
Post Differential Allowance	4,800	7,100	2,300
Other Allowances and Benefits	29,600	32,200	2,600
Relocation and Real Estate Fees	25,000	30,800	5,800
Shelter–Related Provisions	37,200	52,300	15,100
Total Increase			**32,900**

Exhibit 22.11

Expenditures on Foreign Service Directives in 1988–89 and 1993–94 ($ 000s)

Source: Supply and Services Report #9005 (1988–89); Supply and Services Report #9005 (1993–94)

Information Technology

Background

22.143 Modern information and communication systems offer the Department unprecedented opportunities to reshape its delivery processes. The Department's budget is under pressure. Sound investments in information technology can lead to higher quality services that are tailored to changing needs and delivered more effectively, faster and at lower cost.

22.144 Since the mid–1980s, the Department has increased its use of information technology. One of its major initiatives in this area was its Canadian On–line Secure Information and Communications System (COSICS) project. COSICS was expected to improve administrative efficiency and reduce person–years.

22.145 We audited COSICS in 1987 and did a follow–up audit in 1989. In 1987, we reported that the Department risked exceeding cost estimates and that predicted savings would not be realized. In 1989, we reported further cost increases, and again expressed concern that some of the expected savings in person–years would not be fully realized. Although the Department originally expected to complete Phase I of COSICS in the fall of 1989, it modified the delivery date to the fall of 1991.

22.146 In February 1991, we reported that having spent $53 million, the Department had reassessed the COSICS project and decided not to proceed with Phase II. We supported the Department's decision.

22.147 In 1992, the Standing Committee on Public Accounts held hearings on the COSICS project. By that time, the Department had revised its approach to information technology. It presented a plan to the Standing Committee on Public Accounts for implementation of its total computerization program. The Department proposed a more open architecture and the use of off–the–shelf software for systems under development. It called the new approach Secure Integrated Global Network or SIGNET. We will monitor future developments in SIGNET.

22.148 The Department continues to invest millions of dollars in information technology. In 1993–94, the Department spent approximately $100 million or 7 percent of its total budget on information technology and related activities. Like many other government departments, the Department continuously looks at how it can use information technology to reorganize and redesign its work.

22.149 The Department's investment in information technology has been having an evolutionary impact over the last few years. This changing impact will continue with SIGNET. SIGNET will have major implications for the way officers in the Department will interact worldwide and for the use of information in the Department.

Our main concern was how the Department is managing the proliferation of information technology in its various branches.

Accountability needs clarification

22.150 Given the significance of the investment in information technology, our audit concentrated on an overview of the Department's information technology activities. Our main concern was how the Department is managing the proliferation of information technology in its various branches.

22.151 In our view, the Department needs to take a more consistent approach to the management of its information technology investment and provide one focal point for corporate accountability.

So far, the Department has had an uneven approach to controlling its investment in information technology. As a result, it may not have realized the full benefits of its investment. For example, the lack of compatibility between the FINEX (financial) and the INFONNEL (personnel) systems creates difficulty in analyzing all aspects of the cost and numbers of persons working for the Department at any particular time or place. We believe that the Department's effectiveness in the area of information technology would be enhanced by designating a single corporate focal point that would have full authority and accountability for its informatics initiatives and expenditures.

22.152 In 1991, the Department set up a Technology Board to oversee and co–ordinate its overall technological direction. The Board met three times before it was consolidated with other committees into the Department's Management Committee. The Department has informed us that it has now reconstituted the Technology Board. This step will help clarify accountability for investments in information technology and create more consistency in managing those investments across the Department. The Department has also indicated that it will be producing an Information Management Plan that will allow for a more integrated approach to all aspects of computer applications across the Department. We view these as positive steps.

Future monitoring

22.153 We intend to follow up on our main concern — the management of the information technology investment across the Department. In 1996, we propose to report on the results of our follow–up. Particular attention will be paid to the way information technology is reshaping the delivery of departmental programs and enhancing their cost–effectiveness.

22.154 In summary, while information technology is beginning to reshape many aspects of the Department's activities, applications must be better integrated to realize the full potential of the investment in them.

The Internal Audit Function

22.155 A key component of accountability involves effective independent monitoring of all significant aspects of an organization's performance. Internal audits and evaluations provide this function by reviewing and assessing management practices and controls in major financial, administrative and operating areas, and by recommending improvements where needed.

22.156 The internal audit and program evaluation function is performed within the Department's Office of the Inspector General. The majority of the Inspector General's operating budget of about $3.4 million is dedicated to internal audits. The internal audit and program evaluation function has been reorganized several times since its inception.

22.157 In 1987, we reported that the Department had organizational units in place with clear roles and responsibilities for internal audit and program evaluation. The mandates of these units conformed to guidelines provided by Treasury Board. An Audit and Evaluation Committee oversaw the operations of these units and was responsible for following up on the extent to which major issues raised by internal audit were being addressed.

22.158 Our main concern at that time was that the scope of internal audits was not comprehensive and left out many significant aspects of the Department's

operations. We pointed out that the internal audit function had not participated sufficiently in major systems development to ensure that appropriate internal controls were installed on a timely basis.

22.159 In addition, we reported that there had been few significant studies to measure the effectiveness of the Department's programs.

Internal audit work is making a difference to administrative practices at the missions.

22.160 In 1989, our follow–up work indicated that there had been little progress.

22.161 Three significant events have occurred since 1991. First, the internal audit function began to report to the Assistant Deputy Minister, Corporate Management instead of the Associate Under–Secretary who had been responsible for the management of the Department. Second, departmental senior management refocussed the internal audit function to strengthen the audit of administration and management of missions abroad and to increase the frequency of audits by systematically auditing all missions annually. Between 1993 and 1994, more than 200 internal audits of mission administrative procedures were conducted. Third, the Audit and Evaluation Committee was in place until October 1992 when its responsibilities were assumed by the Management Committee.

Expanding the scope of internal audit work to include more significant aspects of both headquarters and mission activities and operations would increase its overall effectiveness.

22.162 Internal audit work is making a difference to administrative practices at the missions. The deterrent effect of internal audits is now recognized throughout the missions. Compliance with administrative procedures at the missions, which are stipulated by headquarters, is reportedly improving. As well, a number of weaknesses in controls at missions have been identified and are being dealt with on an ongoing basis. In 1994, in response to a number of issues raised by mission audits, the Department's administrative policies were revised to improve, for example, the hospitality directives, the allocation of representative housing and the collection of rent shares.

22.163 In our view, sufficient planning, preparation, investigation and substantiation were conducted to support the internal audit findings.

Need to expand the scope of internal audits

22.164 In 1993, we reiterated to management our long–standing concern about the limited scope of internal audits in this Department, in particular, the lack of headquarters audits. While some headquarters audits had been undertaken since 1987, mission audits of administrative practices and, more recently, the Consular program continued to consume the bulk of the available resources.

22.165 Our concern is that a significant portion of the Department's annual expenditures ($1.4 billion), and many of the activities that are key to its operational success, are not subjected to internal audit. Operational activities in such areas as international trade, political and international security, and administrative support activities at headquarters are not audited.

22.166 We maintain that expanding the scope of internal audit work to include more significant aspects of both headquarters and mission activities and operations would increase the overall effectiveness of the Office of the Inspector General. Because many of the administrative problems uncovered at missions abroad are related to headquarters issues, it is vital that internal audits not be restricted to the missions.

22.167 To expand the scope and mandate of audits effectively, the Office of the

Inspector General will require a broader set of skills and expertise in the programs and subject areas it must review. Auditing program areas such as international trade or major computer systems at headquarters will require multidisciplinary teams and specialist support.

22.168 The Inspector General shares these views and has initiated plans to establish an updated audit universe comprising all major programs and organizational units. In addition to including consular activities as part of the scope of mission audits last year, in 1994 the Office of the Inspector General turned its attention to headquarters functions and operational activities such as trade promotion.

The role of the Audit and Evaluation Committee

22.169 The role, composition and activity of a department's audit and evaluation committee reflects the level of organizational commitment to the internal audit effort. More specifically, the committee can provide the internal direction and support necessary to ensure the independence of the internal audit function; approve the scope of its work; identify critical issues for review; approve the resources needed; provide quality control; and ensure that appropriate and timely action is taken to implement recommendations.

22.170 The Department's Audit and Evaluation Committee, which met on an ad hoc basis until October 1992 when its responsibilities were assumed by the Department's Management Committee, was restructured in April 1994. It is currently chaired by the Deputy Minister for International Trade.

22.171 The restructured Audit and Evaluation Committee will have the opportunity to provide the profile and direction necessary to help the Office of the Inspector General fulfil its mandate. The Committee may wish to consider the following actions:

- assessing the overall effectiveness of the Office's efforts in terms of usefulness and timeliness and setting performance indicators for evaluating the performance of the Office;
- ensuring that the Office's functional reporting relationship is primarily to this Committee, which would enhance the Office's independence and elevate its reporting profile to the deputy minister level; and
- including in the Office's terms of reference the co-ordination of audit work involving other government organizations that operate under the authority of the *Department of External Affairs Act.*

22.172 In summary, the Department should continue in its efforts to expand and strengthen the Office of the Inspector General's review functions. The sustainability of these functions is enhanced by the recent restructuring of the Audit and Evaluation Committee. We will continue to monitor the Department's progress in this area.

The Audit and Evaluation Committee can provide the internal direction and support necessary to ensure the independence of the internal audit function.

Conclusions

22.173 In summary, our audit results indicate that the Department has improved its financial management practices and controls, particularly over the past two years. The Department has undertaken a proactive audit program, the development of a costing model and a management information system, an improvement in financial management and better financial training for employees. All of this activity has the potential to create a sound basis for improved comptrollership. Departmental corporate initiative, reinforced by central agency support, has

brought about a flurry of activity in this area. There are, however, a few key questions that remain to be answered.

- Have these initiatives and changes made a sustainable difference?
- Have the improvements we found been applied consistently across the Department?
- Has the foundation been laid to encourage and assist departmental managers to make responsible and reasonable financial decisions?

22.174 We placed a great deal of emphasis in this audit on the need for effective comptrollership at all levels and on the need for an improved sense of cost awareness among both managers and staff in this complex working environment. We recognize that such concepts require the availability of useful tools and techniques as well as an ongoing adjustment to changing priorities and values. Acceptance of the need for change and implementation of the actions required to accomplish it will take time, central agency support and continued leadership within the Department.

The Department needs to strive to build and nurture improved comptrollership and the long–term changes it will require.

22.175 The Department needs to strive to build and nurture improved comptrollership and the long–term changes it will require. It is imperative, therefore, that corporate senior management continue to champion and reinforce the permanent installation of these changes. To meet this ongoing challenge, there is a need for more recognition and acceptance of the contribution made by financial officers in the Department.

22.176 Comptrollership at the mission level is not solely a departmental issue. It involves a number of other government departments that are resident in missions around the world. More than ever, given fiscal restraint, the accountability of heads of mission needs to be clarified as it relates to the activities of other government departments and the cost of providing services to them. The Department, with the assistance of other government departments, needs to settle this issue of accountability in order to improve operational effectiveness abroad.

22.177 Our reported findings have also indicated a need for the Department to simplify financial and administrative systems and processes. The Department has recognized the need and demonstrated a desire to address this pressing issue. Initiatives such as reducing out–of–date reporting requirements at smaller missions, introducing technological innovations and effecting a reorganization at headquarters can make a difference. There is, however, much more that needs to be done and, in some cases, completely new ways of approaching the issues will be required. The Department should address the challenges in co-operation with Treasury Board and other government departments. We propose to keep a watching brief in the areas of concern raised in this report.

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The audit work reported in this volume was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

Chapter 23

Indian and Northern Affairs Canada

Social Assistance

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Indian and Northern Affairs Canada

Social Assistance

Assistant Auditor General: Don Young
Responsible Auditor: Nancy Cheng

Main Points

23.1 Social assistance to Indians living on reserves is generally provided by their communities and agencies with funding from Indian and Northern Affairs Canada. The Department's expenditures on its social assistance activities have risen over time and have exceeded $1 billion. The rate of increase in expenditures is higher than the rates of inflation and population growth of on–reserve Indians combined.

23.2 The social assistance dependency rate, as defined by the Department, is a measure of the demand for aid for basic needs such as food, clothing and shelter. The rates among on–reserve Indians are high and have been on the rise. In 1992, an average of 43 percent of on–reserve Indians were beneficiaries of these services. In many First Nations communities the reliance on assistance for subsistence is substantial.

23.3 While the Department has undertaken several initiatives over the years to alleviate the high level of demand for services, it needs to work more closely with First Nations communities and their leaders to search for an effective solution. It requires appropriate data to analyze the major causes of dependency and to help mitigate them. In addition, the Department needs to co-ordinate with other federal departments and other levels of government in providing the necessary support. In connection with the federal review of Canada's social security system, the Department needs to provide input and advice and to co-ordinate participation with First Nations.

23.4 The Department did not use provisions of the *Canada Assistance Plan.* As a result, it has no substantive legislative authority for its social assistance activities. It relies on annual appropriation Acts as well as Treasury Board decisions as the basis to provide and fund social assistance. The resulting framework for delivering social assistance is complex, cumbersome and difficult to manage.

23.5 The Department does not have sufficient assurance that social assistance activities it funded have been provided in accordance with the standards it adopted. Our analysis of its monitoring reports showed that there has been a significant degree of non–compliance with requirements; the Department does not have summary information on its monitoring efforts. The Department's arrangements with some provinces need to be re-examined to ensure that they provide an appropriate basis for services to be delivered to on–reserve Indians with the Department's funding.

23.6 The Department needs better data on demographics and social assistance and, for management purposes and accountability to Parliament, it needs to develop additional indicators to measure the effects of its activities.

Background

23.7 In the last decade, more and more Indians living on reserves have become beneficiaries of social assistance funded by the federal government. For many of them, federal social assistance is equivalent to a means of survival.

23.8 Indian and Northern Affairs Canada administers two broad categories of social assistance activities for Indians living on reserves — social maintenance and social support services. It has also been funding social assistance services to certain Indians in their transition to living off–reserve. Some provinces have accepted funding responsibility for these services. The Department is in the process of negotiating with the remaining provinces to transfer the funding responsibility to them.

23.9 The social maintenance activity provides funds and services to eligible individuals and families to help them maintain health, safety, dignity and family unity. Funds are provided for basic needs such as food, clothing, shelter, household supplies and personal needs. There is also a child allowance component payable to a foster family, if specified conditions are met and the child is under care outside the parental home.

23.10 The social support activity comprises child and family services, adult care, family violence services and other social services. The child and family services include providing institutional care, selecting families for foster care and paying for maintenance, counselling, protection and prevention services. Adult care services provide assistance and support such as meal preparation and supervision or nursing care to aged and disabled Indians who are institutionalized. Through the family violence initiative, the Department provides funding to First Nations for community–based services to provide emergency shelter and to deal with other aspects of family violence.

23.11 Under government authority, the Department has adopted provincial standards in funding social assistance services for on–reserve Indians. Departmental data show that over 90 percent of Indian bands deliver their own social maintenance. For other services such as child welfare and support services, the provinces are actively involved, pursuant to provincial laws and regulations.

23.12 Exhibit 23.1 shows the Department's expenditures on social assistance activities from 1984–85 to 1992–93. The costs of social assistance for on–reserve Indians have continued to rise. The Department's Estimates forecast expenditures of $898 million for these activities in 1993–94. The 1994–95 budget for the expenditures, as disclosed in Part III of its Estimates, is just over $1 billion. It represents a 12 percent increase over the previous year and is approximately 20 percent of the Department's total 1994–95 budget for transfer payments.

23.13 The Department's administration of social assistance activities is set against a backdrop of rising federal government expenditures on social assistance for on–reserve Indians, currently exceeding $1 billion. In addition, the federal government has undertaken to study and reform Canada's social policies, which could have a major impact on the activities and the related expenditures.

The costs of social assistance for on–reserve Indians have continued to rise and have exceeded $1 billion.

Audit Scope And Objective

23.14 The audit examined the Department's administration of its social assistance activities. We did not examine provincial programs or the provinces' administration of these activities. Our objective was to assess the Department's delivery of these activities, with a view to helping it improve program administration and achieve better program results and accountability. We also reviewed available data in the Department on the state and extent of social assistance to on–reserve Indians to enhance Parliament's awareness of the situation, thereby encouraging and facilitating action where appropriate.

23.15 In addition to interviews conducted at the Department's headquarters, we visited seven regional offices and some district offices. We also visited some First Nations communities.

Audit Observations And Recommendations

State and Extent of Social Assistance among On–reserve Indians

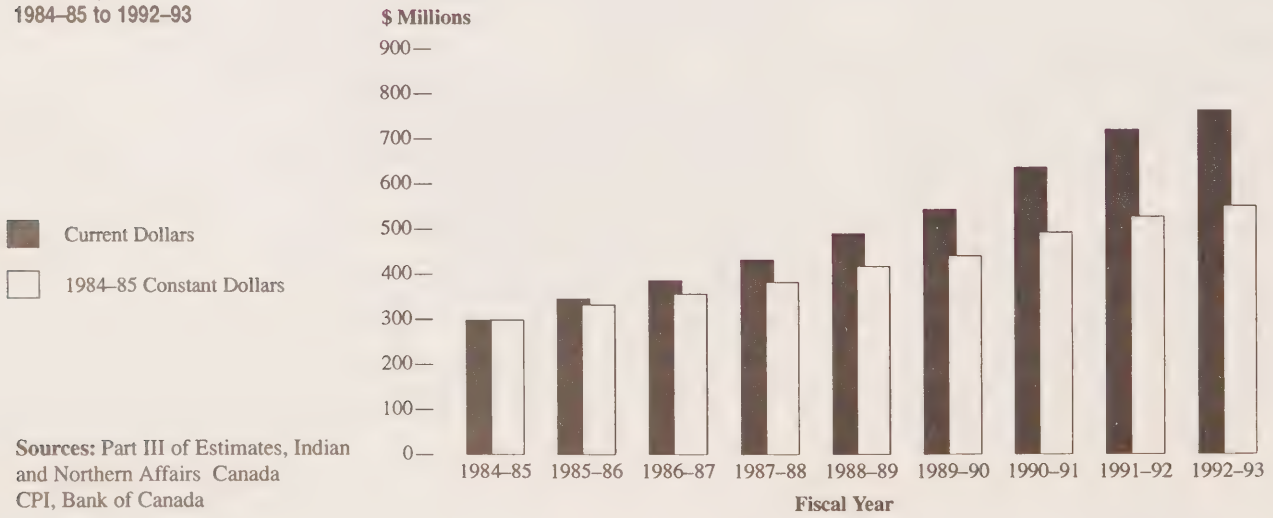
Departmental data show a steady increase in the number of beneficiaries in the last decade, with social assistance dependency rates for on–reserve Indians averaging between 35 and 43 percent from 1981 to 1992.

Social assistance dependency rates among on–reserve Indians are high and have been on the rise

23.16 The Department defines the social assistance dependency rate as the percentage of total on–reserve population who are beneficiaries. Beneficiaries are recipients of social maintenance payments for the purpose of providing for basic needs. The definition includes the recipient's dependants but does not include individuals who receive other forms of social maintenance and support services, such as child and family services. Payment to provide for basic needs represents the largest single component of social assistance, accounting for over half of the

Exhibit 23.1

Costs of Social Assistance Activities, 1984–85 to 1992–93



Sources: Part III of Estimates, Indian and Northern Affairs Canada
CPI, Bank of Canada

Department's expenditures on social assistance activities.

23.17 We noted that departmental data on the number of beneficiaries and the social assistance dependency rate for on–reserve Indians contain definitional variations and approximations. We reviewed the data to gain an awareness of the magnitude and general trend of the demand for social maintenance services among on–reserve Indians, and we have not audited the data.

23.18 Our review of departmental data shows a steady increase in the number of beneficiaries in the last decade (Exhibit 23.2). The change in legislation in 1985 that resulted in the reinstatement to Indian status of certain Aboriginal people and their descendants did not appear to have a significant impact on the number of beneficiaries. The increase from the mid– to late 1980s was slightly higher than in the preceding years and the rising trend continued after this period.

23.19 The high rate of dependency on social maintenance services among First Nations communities is not a recent phenomenon. Data from a 1994 departmental report showed that the social assistance dependency rates for on–reserve Indians averaged 38 percent, and ranged between 35 and 43 percent from 1981 to 1992. During the same period, the dependency rates for Canada, excluding on–reserve Indians, averaged 7 percent and ranged between 6 and 10 percent. Exhibit 23.3 shows the dependency rates for on–reserve Indians and for the general Canadian population from 1981 to 1992.

23.20 The rate of dependency in First Nations communities also varies significantly from one region to another. For example, in 1992 the social assistance dependency rate for these communities

Exhibit 23.2

Departmental Data Show That the Number of Beneficiaries Increased Steadily from 1981 to 1992



Source: Management Information and Analysis Branch, Indian and Northern Affairs Canada

The situation in many First Nations communities has been serious for years and has shown no sign of improvement.

was 74 percent in the Atlantic region, 23 percent in Ontario and 48 percent in Alberta. The rates by region among on–reserve Indians contrast sharply against rates for the general Canadian population (Exhibit 23.4). It would have been more informative to compare dependency rates between a First Nations community and a neighbouring municipality. However, data to support this type of comparison are not readily available.

23.21 Although the data contain some definitional variations and approximations, they show a high level of social assistance dependency rates among on–reserve Indians, and a general rising trend. In addition, the annual population growth rate of on–reserve Indians has been averaging about three percent since 1982.

23.22 The growth in both social assistance dependency rates and population have increased the demand for social assistance expenditures on Indians living on reserves. Over the years, the Department's expenditures on social assistance have risen faster than the rates of inflation and population growth combined. Current fiscal realities allow for limited flexibility to meet future demands for funding, especially given the likelihood that the demands will continue to increase.

23.23 Furthermore, the situation in many First Nations communities has been serious for years and has shown no sign of improvement. While ongoing funding provides basic relief, the assistance is only for the short term and does not address the high level of demand for services. It also leaves some fundamental questions unanswered:

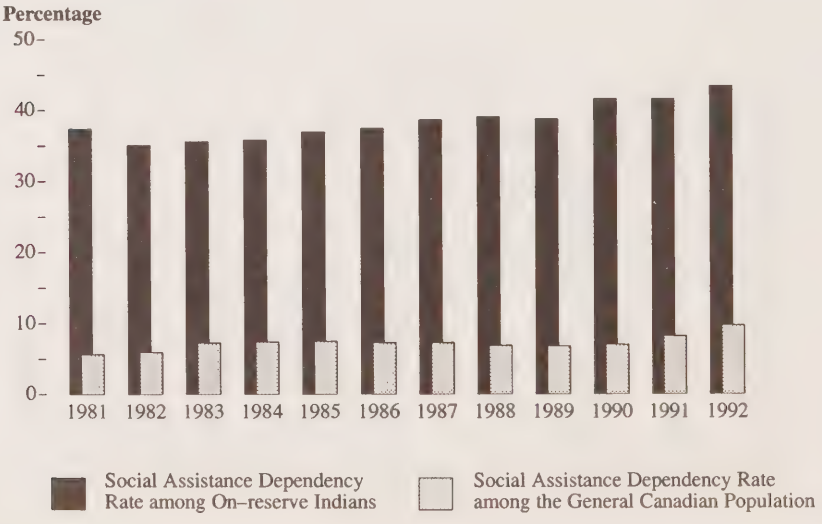
- Why does this situation persist?
- Could it be improved?
- Should our society accept this as a way of life for on–reserve Indians?

Despite a growing concern and the undertaking of certain initiatives, dependency rates have continued to rise

23.24 The Department has recognized a need to address the increasing demands for social assistance. Over the years, it has undertaken initiatives to provide funding for employment and training opportunities for beneficiaries. The initiatives included the Work Opportunity

Exhibit 23.3

The Social Assistance Dependency Rates among On–reserve Indians and for the General Canadian Population, 1981 to 1992



Source: Management Information and Analysis Branch, Indian and Northern Affairs Canada

Program, Band Work Process, New Employment Expansion Development Program and Indian Community Human Resources Development Strategies.

23.25 The Department has sought and received Treasury Board authorities and government directives to fund projects proposed and administered by the bands to create employment and training opportunities for the beneficiaries. The expenditures arising from these initiatives have amounted to approximately one or two percent of the total social assistance costs. The Work Opportunity Program and the Indian Community Human Resources Development Strategies are still in place to help reduce the dependency rates among on–reserve Indians.

23.26 In 1989, the Canadian Aboriginal Economic Development (CAED) Strategy was launched as a major multidepartmental initiative. The implementation of the strategy was estimated to cost about $1 billion and one of its expected achievements was to decrease Indian dependency on social assistance. Among observations in our 1993 audit of the CAED Strategy, we noted that there had been no evaluation of its results. Accordingly, it was not known to what extent the objectives were being met. As of May 1994, the evaluation had yet to be completed.

23.27 However, the Department has no formally stated objective that acknowledges the need to monitor the demand for social assistance and the rising dependency rates to address them where appropriate. The Department has not analyzed the social assistance dependency rates in the circumstances of the individual First Nations communities and determined if improvements are feasible and practical. Although the Department has considered the rising social assistance expenditures in planning its activities, it has not assessed adequately the fiscal

The Department has no formally stated objective that acknowledges the need to monitor the demand for social assistance and the rising dependency rates to address them where appropriate.

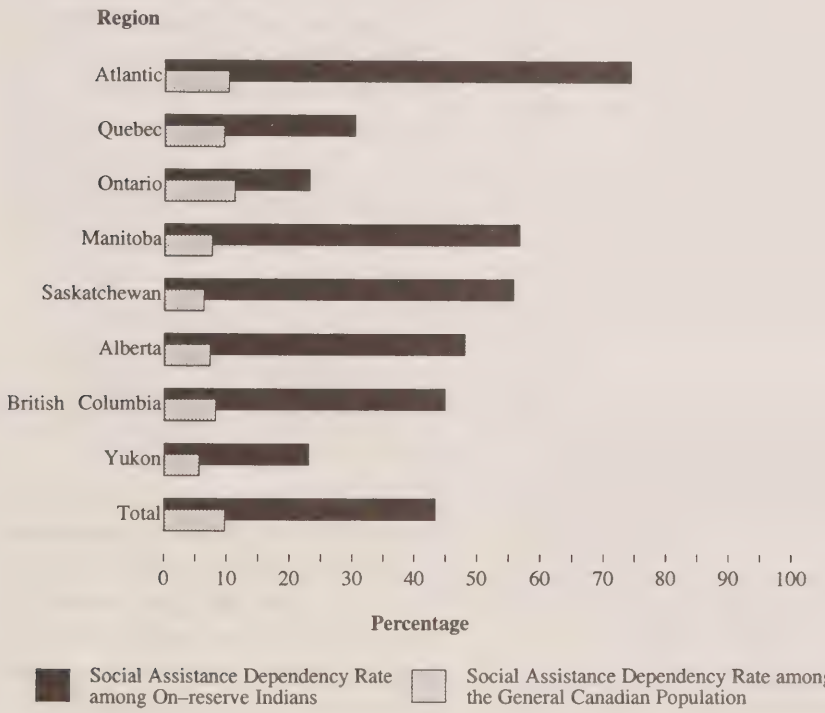


Exhibit 23.4

The 1992 Social Assistance Dependency Rates among On–reserve Indians and for the General Canadian Population

By Region

Source: Management Information and Analysis Branch, Indian and Northern Affairs Canada

implications if the trend in the social assistance dependency rate continues.

23.28 In 1993, in response to a growing concern about the rise in social assistance costs, the Department initiated a research project to determine the underlying causes of the rising trend, and the factors associated with keeping First Nations people off social assistance.

Canada's reform of the social security system presents an opportunity for the Department to provide input and advice on issues as they relate to on–reserve Indians.

23.29 The project set out to explore the relationship between the changing demand for social assistance and the demographic and socio–economic characteristics of registered Indians at individual and community levels. Its terms of reference also included studying differences among regions and comparisons with the general Canadian population. During the audit, the Department advised us that the project had to be deferred and reduced in scope because some of the necessary data to carry out the research were not available.

23.30 We are concerned that some empirical data needed to analyze the major causes of the increasing dependency trend are not available and that the Department is not in a position to assess the nature and extent of the efforts needed to deal with the causal factors and to mitigate the rising demands for social assistance on reserves. Despite initiatives over time, and the CAED Strategy, the trend of social assistance dependency rates among on–reserve Indians has continued to rise.

In searching for an effective solution, appropriate data and analysis and further involvement of First Nations communities and their leaders are needed

23.31 Reducing the demand for social assistance is usually associated with creating jobs and other business opportunities. In many First Nations communities, such efforts are often hampered by many factors, including:

- remote location of the community;
- inadequate infrastructure on the reserve;
- limited access to capital and business opportunity; and
- lack of skilled labour.

Making the challenge even more difficult are the underlying need to reconcile the efforts with First Nations values and culture; the diversity of First Nations; and the complexity of the legislative environment affecting on–reserve Indians.

23.32 There is no ready solution to meeting the challenge and it is unlikely that the Department, by itself, can effectively reduce the increasing demand for social assistance on reserves. The search for effective solutions needs to actively involve First Nations communities and their leaders. Working with them in partnership, the Department could initiate, facilitate and support actions and seek to co-ordinate activities with other federal government departments and other levels of government as appropriate.

23.33 In late January 1994, the federal government announced an undertaking to consult broadly, to analyze and to make recommendations for modernizing and restructuring Canada's social security system. The scope of the undertaking includes reviewing ways of delivering training and employment programs, social assistance and aid to education and learning.

23.34 Changes arising from the federal reform of the social security system could affect all Canadians, including on–reserve Indians. The reform presents an opportunity for the Department to provide input and advice on issues as they relate to

on–reserve Indians. The Department could also play a role in co-ordinating the involvement of First Nations in Canada's social security reform.

23.35 Further, it provides an opportunity for the Department to act, before any changes take effect, by assessing the reform's potential impact on the Department's social assistance activities and by considering the possible need for complementary activities. The Department advised us that it has been participating with Human Resources Development Canada on these matters since May 1994.

23.36 The Department should develop appropriate data to support its analysis of the major causes of the increasing demand for social assistance among on–reserve Indians. In developing initiatives to mitigate the causes, the Department should continue to work in partnership with First Nations communities and their leaders. The Department should co-ordinate its efforts with those of other federal departments and agencies involved and with other levels of government, to provide the necessary support for the initiatives.

23.37 The Department should ensure that appropriate input and advice relating to First Nations are provided to the responsible bodies overseeing the federal social reform initiative and co-ordinate the involvement of First Nations in the reform. In addition, it should assess the potential impact on First Nations of changes that may arise from the reform and take appropriate steps to prepare for the implementation of such changes.

Legislative Authority and Framework for Delivery

The lack of substantive legislative authority could undermine parliamentary control and accountability

23.38 We would expect clear and substantive legislative authority for major program activities such as social assistance to on–reserve Indians provided and funded by the Department. We found that the Department has not used existing legislative provisions and, as a result, it does not have clear and substantive legislative authority for its social assistance activities.

23.39 The *Constitution Act, 1867* allocates legislative powers between Parliament and the provincial legislatures, and provides the basis for Parliament to make laws in relation to Indians and the lands reserved for them. Without the enactment of appropriate legislation, the *Constitution Act* alone does not provide legislative authority, or impose a legal obligation on the Department, to provide and fund social assistance activities for on–reserve Indians.

23.40 The *Indian Act* contemplates applying provincial laws to Indians living in that province. While the Department provides and funds social assistance activities, the *Indian Act* does not specify any legal obligation to do so.

23.41 The *Canada Assistance Plan* was enacted in 1966 to encourage further development and extension of assistance and welfare services throughout Canada, by providing an instrument to allow the federal government to share costs with the provinces. Part II of the Plan relates specifically to Indian welfare. Under Part II, the Minister of Indian and Northern Affairs, with the Minister of Human

Resources Development (formerly National Health and Welfare), may enter into an agreement with a province to extend provincial welfare programs to Indians and to share the additional costs.

23.42 The Department entered into an agreement with Ontario in 1965 for Indian welfare administration (the 1965 Agreement), before the *Canada Assistance Plan* took effect. There has been no agreement under the Plan with any province since it came into effect. Hence, the Department has not used the Plan's provisions, which could have offered substantive legislative authority and a program framework for the Department to deliver and fund its social assistance activities for on–reserve Indians.

In place of substantive legislative authority, the Department derives funding authority from its annual appropriation Acts and relies on Treasury Board decisions and other government directives as the basis of authority for its social assistance activities.

23.43 In place of substantive legislative authority, the Department derives funding authority from its annual appropriation Acts and relies on Treasury Board decisions and other government directives as the basis of authority for its social assistance activities.

23.44 The lack of substantive legislative authority could undermine parliamentary control and accountability. It precludes parliamentary debate on important questions such as whether a social assistance program for on–reserve Indians should address reducing the demand for services in addition to supplying the services, and what the appropriate benefits ought to be. In addition, it does not provide an instrument for Parliament to hold the Department accountable against program authorities, beyond those approved by the Treasury Board.

The framework for delivering social assistance is complex, cumbersome and difficult to manage

23.45 We noted that there have been close to 100 Treasury Board authorities and government directives, many predating the 1966 *Canada Assistance Plan*. Of these authorities, about a third are still in force. By convention and under a 1964 Treasury Board authority, the Department has adopted provincial standards, including eligibility criteria and terms and conditions of benefits for Indians on reserves, in providing for basic needs.

23.46 In departmental regions and districts, the respective provincial policy and procedure manuals, along with the numerous Treasury Board authorities and government directives and any resulting agreements, have become the delivery and funding framework for social assistance to First Nations. In the absence of agreements made pursuant to the *Canada Assistance Plan*, the legislative authority for adopting provincial standards has not been clarified. In addition, the framework for delivery that has developed from this multiplicity of authorities is complex, cumbersome and difficult to manage.

23.47 For example, the funding of social assistance by departmental staff is directly affected by changes in provincial legislation, from the terms and conditions of benefits to the nature of services. Thus, it is a challenge for the Department's staff to remain fully knowledgeable and up–to–date on provincial standards, advise band administrators of changes on a timely basis and provide training as appropriate.

23.48 Moreover, it is difficult for the Department to ensure that eligible Indians living on reserves are receiving social

assistance services comparable with other recipients in the general population of the same province. We noted that the Department has completed comparability reviews of some aspects of social maintenance services, such as eligibility, by comparing provincial procedure manuals with those used by bands, which are based on procedure manuals of the Department. However, we found that the Department is still in the process of completing comparisons of the levels and quality of its social support services, such as child support and adult care services, with those available in the same province.

23.49 In many instances, even monitoring First Nations' compliance with provincial guidelines for delivering social maintenance services is not simple. As an illustration, most municipalities in one province have exercised their prerogative to modify rates and conditions for social maintenance services. It could become very time–consuming and costly to monitor compliance with standards when they vary from one area to another in the same province.

23.50 Recently, certain provinces have acknowledged that many of their welfare programs have not been subjected to rigorous review and some may no longer be appropriate in today's environment. One 1993 provincial report concluded that some of the provincial Acts governing welfare have not been changed since their inception and are out of step with the economic and social realities of the 1990s. In December 1993, another province acknowledged that the root causes of family insecurity and poverty must be addressed by providing people with opportunities to learn new skills and develop their full potential. In addition, it proposed that beneficiaries of social assistance also have responsibilities to seek and accept employment and pursue personal development, education and training.

23.51 Furthermore, under the current framework for delivery based on provincial standards, the Department has no assurance that the quality and level of services are responsive to the cultural needs of on–reserve Indians.

23.52 The Department should seek substantive legislative authority to enunciate program objectives and provide a basis for its accountability to Parliament for its social assistance activities. Alternatively, it should use existing provisions of the *Canada Assistance Plan* for the activities.

23.53 The Department should determine whether delivery and funding of services are consistent and comparable within each region and, taking into account cultural needs of on–reserve Indians, take action as appropriate.

Management and Accountability for Social Assistance Activities

23.54 In its administration of social assistance activities, we would expect the Department to have sufficient and appropriate management and accountability mechanisms in place to ensure that services are delivered in compliance with applicable authorities and agreements. In cases where the services are being provided by a third party with the Department's funding, we would expect the Department to obtain assurance that the responsibilities for social assistance activities are properly discharged. We would also expect the Department to continue to be accountable for the use of public funds.

23.55 Departmental data show that over 90 percent of Indian bands deliver their own social maintenance services to their

Given that the Department relies on the Indian bands and the provinces to carry out most of its social assistance activities, we believe that it needs to define and obtain the assurances it requires from these relationships.

members, with funding from the Department. Outside Ontario, the Department generally enters into an agreement with a First Nations community and/or agency to deliver maintenance services without involving the provincial government. Under the terms of the 1965 Agreement between Canada and Ontario, the Province of Ontario provides and funds social assistance services to on–reserve Indians and seeks reimbursement from the Department. The Ontario government also arranges with certain bands to deliver services directly through their own communities or agencies. In cases such as child maintenance and support services, the provinces are actively involved, pursuant to provincial laws and regulations.

23.56 The Department views its role as one of providing funding to First Nations for on–reserve individuals and families who are eligible to receive social maintenance services in a manner comparable with the general population in the same province. In the Department's view, its role also includes assisting First Nations in providing on–reserve Indians with social support services comparable to those provided to the general population in the same province.

23.57 Given that the Department relies on the Indian bands and the provinces to carry out most of its social assistance activities, we believe that it needs to define and obtain the assurances it requires from these relationships.

The Department has not obtained sufficient assurance that its management responsibility has been properly discharged

23.58 The funding and service agreements are usually negotiated among the Department, the Indian bands and agencies, and the provinces, depending on the service to be provided. The funding of the services is governed primarily by the terms and conditions of an agreement on funding arrangements. The bands and agencies are expected to demonstrate that the services they provide comply with the Department's policies and the respective provincial standards.

23.59 The funding agreements obligate Indian bands to submit audited financial statements annually, usually within three months after the fiscal year–end. During our regional visits, we were advised that audited financial statements from the bands are often late by months and sometimes remain outstanding.

23.60 We reviewed departmental statistics and are encouraged to see that the 1992–93 audited statements were submitted much earlier than those for 1991–92. For example, by September 1993 the Department had received 78 percent of all 1992–93 audited statements, compared with 57 percent received a year ago for 1991–92. At the time we concluded our audit in May 1994, less than one percent of the 1992–93 statements remained outstanding.

23.61 However, the standard auditor's report provides financial attestation to the statements; it does not generally comment on the band's compliance with terms of the contribution agreement or with departmental policies and procedures. The reports offer limited assurance to the Department that its responsibilities for delivering its social assistance services have been properly discharged.

23.62 The Department's policy also requires it to monitor social assistance activities through desk and field reviews. Desk reviews focus on the validity and reasonableness of submitted data and do not involve visits to First Nations communities. Field reviews consist of on–site examinations of records and

documents maintained by bands and agencies, to determine compliance with eligibility criteria and applicable rates and conditions. Since September 1990, departmental guidelines have required that field reviews of all bands be conducted generally every two years.

23.63 In each of the regions we visited, we selected and examined a number of field reviews carried out and documented by the Department. In Ontario, the Department arranged with officials of the provincial government for us to examine the reports of some reviews carried out by the province.

23.64 In total, we examined over 40 percent of the available reports on department–wide field reviews for 1992–93 and 1993–94. These reports contained findings on about 2,400 case files that were examined by the Department.

23.65 Although the reports identified specific findings, we found that not all regions and districts had summarized the information. Some were not able to advise us of the number of field reviews that had been carried out. In addition, information was not readily available on how well the Department's guideline on the frequency of such reviews has been respected.

23.66 We summarized the instances of non–compliance in the nation–wide sample of the 2,400 case files and found the extent of non–compliance with requirements to be significant (Exhibit 23.5). For example, we noted that over 70 percent of band case files lacked adequate documentation. The non–compliance ranged from missing application forms or other required documents, such as a medical certificate, to forms that were improperly completed. We noted that there had been some follow–up of these and other cases of non–compliance with requirements. However, due to the financial situation on many reserves, recovery actions, if warranted, are often difficult and not feasible.

23.67 The extent to which documentation is inadequate points to a systemic problem. However, it is unclear whether the non–compliance is largely in form or in substance. The former may suggest that more training is required or that the requirement for documentation is too bureaucratic and not consistent with First Nations culture. But the latter may signal that public funds are at risk. The Department faces the challenge of ascertaining the nature of the non–compliance and, where necessary, modifying its control mechanisms to respect First Nations culture while safeguarding public funds.

23.68 Moreover, our concern is that there is no national summary or analysis of the results of the field reviews and the Department has not obtained sufficient assurance that its management responsibility to provide and fund social assistance services is being properly discharged. Furthermore, the Department is not in a position to assess properly the extent of non–compliance and take appropriate corrective action. Without proper follow–up and appropriate

The Department faces the challenge of ascertaining the nature of the non–compliance and, where necessary, modifying its control mechanisms to respect the First Nations culture while safeguarding public funds.

Exhibit 23.5

Case Files Subjected to Field Reviews Show a Significant Extent of Non–compliance with Requirements

Number of files included in the reviews	**2,411**	**(100%)**
FINDINGS		
Inadequate documentation	1,784	(74%)
Insufficient income verification	532	(22%)
Improper entitlement calculation	397	(16%)
Other	234	(10%)

Percentages totalling over 100 percent due to multiple occurrences of findings in a case file.

Source: 1990–93 field reviews, Indian and Northern Affairs Canada

remedial action, public funds to finance these payments may not be serving their intended purposes. In these circumstances, it is difficult for the Department to provide assurance to Parliament that the funds have been properly used for social assistance activities.

The Department will need to take a more cost–effective approach to monitoring its social assistance activities

23.69 The continuing trend to downsize the Department and the increasing devolution of responsibility to Indian bands have generally reduced the level of resources formerly dedicated to the administration of social assistance activities. In our view, the reduction in the level of resources in a time of continued or increasing demands for social assistance will require the Department to take a more cost–effective approach to monitoring.

Although there have been occasional amendments to the 1965 Agreement, the Department acknowledges that many of its concerns still exist today.

23.70 One option is the use of risk profiles. Based on data from previous desk and field reviews, the Department could categorize bands and agencies into various profiles of risk and assign an appropriate frequency and extent of on–site review accordingly. Results from successive reviews would be used to update the risk profiles of the bands. The use of risk profiles would also allow the Department the flexibility to vary the extent of its monitoring by region.

23.71 Another option is an increased use of analytical review to strike a balance between desk and field reviews. The Department could assess whether a change in the level of funding to a band is reasonable in the circumstances and determine if a desk review would suffice. Other approaches could include a better use of information technology and sampling techniques.

The Department's arrangements with some provinces need to be re-examined

23.72 Under authorities provided by Treasury Board decisions, the Department entered into bilateral and tripartite agreements with individual bands and the provinces, depending on the type of services, to provide and fund social assistance activities. Paragraph 23.42 refers to the 1965 Agreement between Canada and Ontario, the only general agreement whereby the province has agreed to administer welfare services for on–reserve Indians with funding from the Department. The Department's social maintenance expenditures in the Ontario region amount to about $130 million annually.

23.73 In a 1985 analysis of the social maintenance services provided to Indians living on reserves in Ontario, the Department expressed concern that the responsibilities for the range, quality and cost of services under the 1965 Agreement were ambiguous. It concluded that the absence of a formally constituted tripartite forum — among First Nations, the province and the Department — caused persistent difficulties in the delivery and funding of services. Further, it concluded that the 1965 Agreement was inadequate for the devolution of social programs to the Indian bands.

23.74 Although there have been occasional amendments to the 1965 Agreement, the Department acknowledges that many of its concerns still exist today.

23.75 The 1965 Agreement requires the province to conduct specific audits of social maintenance payments made to on–reserve Indians. Under the Agreement, the province reports its findings to the Department. Until its most recent report to the Department for 1989–90, we noted that the audits appeared to focus on technical coding and

administrative requirements and did not offer assurance that eligibility requirements had been met.

23.76 We also found that the audit reports have not been timely. They generally lag behind the fiscal period by three to six years. Follow–up and remedial action, if needed, would likely not be effective given the time lag. In fact, in a preliminary audit report for the 1989–90 fiscal year prepared in April 1993, the auditors indicated that they had been unable to verify a significant portion of social maintenance payments in one district. They noted that the client files lacked documentation and sufficient detail to establish eligibility. The issue was still unresolved when we concluded our audit in May 1994. If there were ineligible payments, public funds would have been misused. The payments in question amounted to about $12 million, representing about 9 percent of the Department's annual social assistance expenditures in the Ontario region.

23.77 In another region, the Department has an informal arrangement with the province whereby it reimburses the province certain costs for the child maintenance and support services delivered in that province. The basis of the funding formula has evolved over time and has never been formalized. The Department advised us that about $16 million is paid annually to the province for these services.

23.78 In 1986, the Department drafted a memorandum of understanding to formalize its funding arrangement with that province for child welfare and support services. The draft memorandum contains provisions on the terms and conditions of reimbursements by the Department, including the submission of accounts by the province for the Department's verification and Canada's discretion to request an audit of the province's records pertaining to the services funded. The draft memorandum has not been signed and about $100 million has been paid by the Department.

23.79 Since 1986, the Department has continued to fund child maintenance and support services under the informal arrangement. The Department has not monitored the delivery of these services; nor has it received monitoring reports from the province. As a result, the Department does not have the necessary assurance that the services for which the funds were intended have been delivered.

23.80 The Department has raised some overall concerns about the adequacy of the 1965 Agreement as an instrument for the delivery of services in Ontario. The reporting required under the 1965 Agreement does not provide sufficient assurance to the Department that its management responsibility is being discharged. The informal arrangements with the other province also fail to provide the assurance that the Department needs in funding the services. In our view, the Department needs to re-examine some of its arrangements with provinces in carrying out its social assistance activities.

Better demographic and social assistance data and performance indicators are needed for management and accountability

23.81 The Department's management information on its social assistance activities consists primarily of data on funds expended, and operational data such as caseloads.

23.82 The Department recognizes the need for better data on band demographics and social assistance. In 1990, it obtained authority to have a census–based survey of Aboriginal peoples implemented, at an estimated cost of $14 million. Its supplier,

The basis of the funding formula for child maintenance and support services delivered in a province has evolved over time and has never been formalized.

We are concerned that the Department does not have sufficient data for analyzing major causes of demands for social assistance and supporting the search for means to mitigate the causes.

Statistics Canada, was to complete the project in a period of about five years. Some of the data sought included employment success factors and barriers, subsistence activities, literacy levels, use of training programs, and mobility patterns.

23.83 Although the project's terms of reference and deliverables were discussed, we noted that the Department and Statistics Canada did not enter into a written agreement or memorandum of understanding to formalize the arrangements. As of May 1994, many of the Department's requests had been processed. Statistics Canada advised us that the remaining survey products will be released during 1994–95.

23.84 In paragraph 23.29, we noted that the Department deferred a 1993 research project to study the rise of social assistance costs, in part due to a lack of certain essential data. The necessary data elements as identified in the project proposal include:

- age, sex and marital status;
- the community's marital dissolution rate;
- migration to reserves as a result of Bill C–31, concerning the regaining of status as registered Indians;
- the community's social assistance dependency rate;
- education and training;
- disability rate and health condition in the community;
- employability;
- job opportunities on or near reserves;
- housing needs; and
- community income levels.

23.85 We are concerned that the Department does not have sufficient data for analyzing major causes of demands for social assistance and supporting the search for means to mitigate the causes. For example, we requested information on dependency rates by band and the Department was unable to furnish us with data that it believes are sufficiently reliable.

23.86 The Department has identified performance indicators in its Part III of the Estimates. For social maintenance activities, they include such indicators as percentage of applicants receiving assistance, and comparability of departmental and provincial eligibility criteria. For social support activities, the indicators include percentage of child and family services administered by First Nations during the year, and comparability of access to child and family services by on–reserve Indians and the general population in the same provinces.

23.87 As we reported in paragraph 23.48, the Department is still addressing the feasibility of comparing levels and quality of social support services, such as child support and adult care services.

23.88 However, we believe that the Department needs to develop additional performance indicators to capture the results of its social assistance activities. It needs better indicators of effects of the activities to help management and Parliament assess the extent to which progress is being made.

23.89 In the area of child and family support services, such indicators could include the degree of success in placing a child in a group or foster home or an institution, where the child adjusts to the new environment and requires no subsequent assistance. For social maintenance payments in support of basic needs, indicators could include the length

of time during which beneficiaries require assistance and the frequency with which they require it.

23.90 We understand that the Department is undertaking initiatives, in a broad context, to improve the accountability relationship between band administrations and their members. However, the accountability relationship between the Department and Parliament will continue to require the gathering and reporting of information on the intended and unintended effects of program activities.

23.91 The Department should improve its management and accountability by obtaining appropriate assurance from the bands and agencies that are delivering social assistance services on its behalf. It should also consider taking a more cost–effective approach to monitoring.

23.92 The Department should re-examine its arrangements with some provinces, and amend or replace existing agreements as appropriate or formalize long–standing arrangements, to ensure that they provide a proper basis for delivery of services and sufficient assurance to the Department that Indians living on reserves are being served according to the applicable rates and conditions.

23.93 The Department should continue to pursue its search for appropriate data, including the completion of significant survey projects, and develop additional performance indicators to better serve management needs and its accountability relationships.

Conclusion

23.94 The social assistance dependency rates among on–reserve Indians are high and have continued to rise. Improvements in the delivery of social assistance services alone would not substantially change the desperate need for assistance on many reserves.

23.95 In seeking solutions to mitigate the causes of the rising demand for assistance, the Department needs better data to analyze the major causes of the rising trend. In addition, First Nations communities and their leaders need to play a major role. Given their fundamental need to preserve First Nations values and culture, it would be unlikely that their problems could be adequately addressed by solutions imposed from outside.

23.96 The current federal review of social policy could affect social programs for all Canadians, including on–reserve Indians. It presents a major opportunity for the Department to offer input and advice and to co-ordinate the involvement of First Nations.

23.97 Although the Department acts generally as a funding agency in the delivery of social assistance services, it remains accountable to Parliament for the use of the funds. It needs to obtain sufficient and appropriate assurance that its management responsibility is being properly discharged.

Although the Department acts generally as a funding agency in the delivery of social assistance services, it remains accountable to Parliament for the use of the funds. It needs to obtain sufficient and appropriate assurance that its management responsibility is being properly discharged.

Department's response: *The Department generally concurs with the recommendations, and is reviewing these for remedial action as appropriate. During this year the Department has augmented its management and accountability of the program and is examining further opportunities through increased and more effective compliance reviews and monitoring. The Department*

is improving the integrity of its social assistance data collection. Further departmental activities covering the analysis of on–reserve dependency rates will be largely determined by government–wide initiatives, including those following upon the current social reform exercise. The Department is actively participating as a full member in the social reform activity. Nevertheless, the Department considers that First Nations are fully capable and desirous of articulating their views directly to those overseeing the federal social reform initiative, as well as analyzing and commenting upon the impacts of any changes that may arise. The Department believes the legislative instruments and other mechanisms that presently exist provide suitable accountability to Parliament on the operation of this social assistance program. In addition, the Department considers that it would be more relevant to await the results of the government's social policy reform initiative in determining whether or not it is appropriate or necessary to develop specific legislative authority for the social assistance program, or to enter into negotiations to extend the application of the Canada Assistance Plan.

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The audit work reported in this volume was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

Chapter 24

National Defence

Defence Management Systems

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National Defence

Defence Management Systems

Assistant Auditor General: David Rattray
Responsible Auditor: Peter Kasurak

Main Points

24.1 The Department of National Defence uses a complex management structure that, fundamentally, has been unchanged since 1972. It employs about 11,000 military and civilian staff in its major headquarters to operate this structure.

24.2 We examined the basic building blocks of the Department's overall management system: the defence policy planning and force development system; cost management systems; the military readiness reporting systems; and the systems used to manage personnel, supplies and medical resources in emergencies and war. We found significant problems in each of these building blocks.

24.3 Affordability of long–term plans remains a problem. The 1993 force structure — which omitted many of the elements needed to implement defence policy — required more resources than were available to the Department.

24.4 Policy statements need to contain details of the kinds of conflict situations the Canadian Forces are designed to deal with. This information is required by force planners and the Canadian public to understand the capabilities that are required and that are being created.

24.5 The Department recognizes the importance of cost management and has begun to improve its systems by implementing "business planning". In the meantime, however, departmental studies have found that managers lack necessary information and that there are often few incentives to minimize costs. Cost–saving initiatives have been delayed because information is not available.

24.6 The main system for reporting on current military readiness is not based primarily on objective data, as departmental documents state, but on commanders' judgments. Higher headquarters cannot always determine easily how units have applied readiness standards. Command–level systems have not been implemented fully. During the last year, the Commands carried out about 73 percent of the major military exercises approved by commanders, primarily due to United Nations taskings and budget reductions. This has diminished the ability of commanders to assess the overall readiness of their forces.

24.7 Long–standing deficiencies still exist in information needed to manage personnel, supplies and medical resources in emergencies and war. The Department has projects under way to address these problems; they will not be fully implemented until 2002.

Introduction

24.8 The Department of National Defence and the Canadian Forces require management systems to plan, organize, direct and control the defence of Canada. Although to some the word "management" might imply a purely civilian activity, defence management is integral to both the Canadian Forces and the Department. Defence management includes policy development, long–range planning including force structure planning, management of support functions, and the planning and control of military operations.

24.9 The Department and the Canadian Forces have invested heavily in their support systems for management and decision making. There are about 11,000 people working in the various major headquarters, with about 8,500 in National Defence Headquarters alone. Salaries amount to approximately $436 million each year. Major headquarters include support services and control functions such as intelligence, mapping and cartography, and general safety and control as well as common and administrative staff. The information and telecommunications systems used by the Department and the Canadian Forces cost an additional $630 million annually and employ 8,000 people. The Department plans to spend about $9.5 billion on information and telecommunications systems over the next 15 years to provide managers and commanders with information.

24.10 The Department of National Defence and the Canadian Forces have a unique, unified management and command system. In 1962 the Royal Commission on Government Organization (the Glassco Commission) noted weaknesses in the defence organization, and recommended more efficient common support services. The Commission also recommended the appointment of a single "Chief of the Canadian Defence Staff". There were subsequent developments in that direction, with the 1964 White Paper calling for reforms to improve interservice co-operation and to overcome weaknesses at national headquarters. Parliament integrated the armed services into a single chain of command in 1964 and unified them into a single service — the present Canadian Forces — in 1967.

24.11 Management problems persisted, however. Capital projects continued to run over budget, apparent duplication between the Department and the Canadian Forces still existed, and policy development was weak. The Minister appointed a Management Review Group in 1971. The report of the Review Group resulted in the merging of the Department, Canadian Forces Headquarters and the Defence Research Board into a single entity — National Defence Headquarters. The reorganization created an Assistant Deputy Minister (Policy) Group and placed public servants at the head of highly centralized materiel and financial management functions. That organization is essentially the one in place today.

The 1972 Management Review Group established the management system that is in place today.

24.12 The Department has made important adjustments since 1972 to improve the control of military operations. Because of problems encountered in major exercises and actual crisis operations throughout the 1980s, the Department defined the roles of National Defence Headquarters and the environmental commands (maritime, land and air) more clearly. The Department also improved military staffs by restructuring them and focussing on "joint" or multi–environment operations.

National Defence employs about 11,000 people in major headquarters (see paragraph 24.9).



National Defence Headquarters



Maritime Command Headquarters



Land Force Command Headquarters



Air Command Headquarters

24.13 The departmental management structure has several important characteristics:

- **"Diarchy"**. The organization of National Defence mixes the civilian Department, managed by the Deputy Minister, with the military headquarters, commanded by the Chief of the Defence Staff. This sharing of responsibility is sometimes called the "diarchy".

- **Centralization**. The predominant concept of organization has been to centralize much decision making in National Defence Headquarters. This has been particularly true with materiel and human resource management.

- **Complexity**. Each major operational and support function has its own organization, staff, management system and regulations that extend from National Defence Headquarters down to units and bases. This requires many committees to co-ordinate work. We found about 300 management committees in National Defence Headquarters alone.

- **Staff rotation**. On average, the Canadian Forces post military officers to new positions every four years or less to meet operational requirements, for career development and because of promotions. We found in 1990 that senior military officers had changed jobs, on average, every 18 months.

- **Collegial responsibility**. Diarchy and complexity mean that civilian managers and military commanders share responsibility. In Part III of the Estimates the Department says:

> The departmental structure, through which decisions on resource allocation are made, is based on a hierarchy of four committees that exercise their authority either through consensus or as advisors to their respective chairmen.

Until 1994–95 the Department said that responsibility was not vested in any single commander or manager. It now says that, "for the most part", heads of commands and groups are accountable and that accountability is "brought together" by senior management at National Defence Headquarters and by the heads of commands.

24.14 The growing complexity of military operations, combined with declining budgets, have increased the importance of management systems to the Department. In his February 1994 Budget impact statement, the Minister said that his overriding objective was to strike a better balance between the operational and the support elements of the Canadian Forces, and to preserve effective forces, capable of combat. The Department has responded with attempts to improve management practices by decentralizing authority and increasing accountability in everyday operations, using the private sector where that makes sense, and attempting to eliminate duplication. The Department is developing a new management process based on "business planning" to support those initiatives.

The Minister has announced his intention to "attack the overhead". The success of departmental management initiatives is critical to this effort.

24.15 The success of the Department's initiatives is critical. If the Department implements planned budget reductions without increasing efficiency, military capability will be reduced. If the Department does not measure military capability accurately, it may inadvertently create "hollow" forces, incapable of fighting.

Previous Studies

24.16 The Office last completed a general review of defence management in 1984. Since then, we have conducted audits of materiel management, human resource management, the management of major capital projects and the Canadian Forces Reserves.

24.17 Common themes have emerged from our audits. We have commented frequently on a lack of strategic direction, especially the lack of complete and approved force structure plans. We also have often expressed concern about the degree to which responsibility is centralized in National Defence Headquarters. We have noted the lack of the necessary flexibility in centralized support systems to support field operations. Nearly all our audits have found that centralization has resulted in management systems that operate very slowly and require extensive paperwork and large staffs to operate. We have also found that operational reporting systems for combat units are inadequate or are not in place. Information on the performance of major support functions, such as materiel and training, has also been lacking. We have found frequently that cost information used to support major decisions has been inaccurate or inadequate.

Audit Scope

24.18 This audit consolidates the work of previous audits that looked individually at major systems, such as materiel management and human resource management. The audit focussed on major defence management systems that span the Department and the Canadian Forces. We concentrated on the essential building blocks of the complete management system: the policy and program development system that gives general direction to the Department and the Canadian Forces; the committee system at National Defence Headquarters, through which important resource allocation decisions are made; supporting systems that provide decision makers with essential information on cost and military performance; and the information used to make decisions throughout major headquarters.

24.19 Our audit was based on a few general criteria:

- There should be overall policy and plans that are adequate to establish priorities and guide the use of resources.
- Senior decision makers should receive a full set of options for any management decision, with their relative costs and benefits presented in a fair and uniform way.
- Appropriate cost information should be available in a timely fashion and used for all decisions that result in the use of resources.
- The Department should have in place procedures to measure accurately and continuously its primary peacetime output — ready military forces.
- Information required to mobilize the Canadian Forces and sustain them in the field should be available. In addition, the Department's emergency and wartime information systems should be tested periodically and their appropriateness validated.

24.20 Our audit did not examine systems used to control military field operations directly. We also excluded systems used to manage large capital projects, because we have given them extensive coverage in previous years.

24.21 The chapter immediately following this one presents the results of our audit of the information technology used to support management and command decision making throughout the Department and the Canadian Forces.

Observations and Recommendations

24.22 In general, we found that most of the major "building blocks" of the overall

management structure we have listed above have significant deficiencies. Top–level plans do not appear adequate to guide resource allocation. Despite the growth of major headquarters, needed information often is not available to decision makers. This is especially true of the cost information necessary to manage resource consumption. We also found that information on the state of readiness of the armed forces is largely subjective or is not collected as frequently as Canadian Forces directives require. Finally, we found that some important information required to manage in time of emergency or war is still not available and that it will take years to correct this.

24.23 The rest of the chapter outlines each of our findings in detail.

The Growth of Major Headquarters Has Stopped

24.24 Operating the Department's management systems requires a large staff. They work mainly in the major headquarters: National Defence Headquarters in Ottawa, headquarters of the three environmental commands (maritime, land and air), and the headquarters reporting directly to the commands.

24.25 The Department has said that, since 1990, it has been in the process of reducing National Defence Headquarters by 20 percent. It intends to reduce National Defence Headquarters by a further 15 percent as part of its response to the 1994 Budget.

24.26 We reviewed the personnel levels of National Defence Headquarters and the environmental commands from 1983 to 1993, using data obtained from the Department's personnel information system. We did not examine Canadian Forces Europe, Canadian Forces Training System, or Canadian Forces Communication Command. We found that, while there was a general decline in the size of the Department overall, the number of staff working at major headquarters continued to grow until last year. While 1993 staff levels have decreased, they are still only 4.3 percent below the 1990 figures (Exhibit 24.1).

Exhibit 24.1

Headquarters Grew between 1983 and 1992



Force Plans Are Unaffordable and Contain Gaps

24.27 Policy planning is the foundation of the management system of any government department. It is where the political process and departmental administration meet. Government departments must translate legislation and political direction into departmental policies and plans to ensure that such direction is implemented.

24.28 During our audit, the government began a Defence Policy Review that was still going on at the end of our audit. The policy review differs from its recent predecessors in that it includes a larger role for Parliament, through hearings by a special joint committee of the Senate and the House of Commons.

24.29 We believed it would be useful to examine recent defence policy reviews conducted within the Department. Those departmental policy reviews and the defence development plan that followed them contain useful lessons for the future about the Department's role in translating national policy into defence forces and plans. Our audit shows that improvements in these processes are needed.

Our audit shows that improvements are needed in the policy planning and force development processes.

Capability objectives are not clearly stated

24.30 Defence planning is the process by which policy options are developed for government consideration. Force development is the planning process used to translate government policy into military forces. These processes are supposed to provide overall direction to the Department of National Defence and the Canadian Forces and are therefore key building blocks in the management control system of the Department. Over 300 officials are involved directly in policy and force development in National Defence Headquarters: 20 in policy planning and about 300 in force development. The 250 intelligence staff in National Defence Headquarters also spend a portion of their time on policy and force development.

24.31 The defence planning and force development processes call for an approved strategic assessment and ministerial guidance on which to base policy and provide benchmarks against which forces can be developed. However, there were no such formal studies for the 1992 *Canadian Defence Policy* statement or the subsequent draft policy statement for 1993. Officials told us that the production of separate, formal analyses was not necessary and, in some cases, perhaps not even desirable. In their view, each government–approved policy statement contains a strategic assessment and, to the extent necessary, a threat assessment based on ongoing monitoring of the international environment. Instead of the process described in departmental documents, they use a process of internal consultation and consensus building through which policy emerges.

24.32 The Defence Policy Statement approved by the Minister provides authoritative guidance to the Department. However, the range of conditions under which the Canadian Forces are expected to operate are stated in very general terms and have not been elaborated for force planners or the Canadian public.

24.33 Although Canadian defence policy has become increasingly specific since the 1970s in describing the military capability needed to implement policy, Canadian policy statements do not yet provide the amount of information furnished in some other countries. For example, the former United States Secretary of Defense provided, in his *Report on the Bottom–Up Review* of that

nation's defence strategy, force structure, modernization, infrastructure and foundations:

- a range of "threat scenarios" defining the types of opponents or situations United States armed forces were expected to face;
- determination of forces required to meet the threat;
- explicit consideration of force options, including varying the levels of sea, land and air forces to be maintained;
- explicit consideration of costs;
- evidence of specific in–depth studies of important options for forces and equipment, including cost and technical risk; and
- a public document disclosing the major choices and decisions that planners made when considering the above factors.

This level of detail is important both to inform Parliament about what the armed services can do and to guide force planners working inside the Department.

24.34 In addition to the United States, we reviewed the defence policy documents of Australia, France and the United Kingdom. We found that none provides details as comprehensive as the *Report on the Bottom–Up Review* but that each provides more details than comparable Canadian documents. For example;

- France's 1994 White Paper, entitled *Livre blanc sur la Défense*, relies on six broad scenarios that could require the use of the French armed forces. The scenarios make it possible to characterize the forces which could be required.
- The *Statement on the Defence Estimates* of the United Kingdom sets out three Defence roles, detailed military tasks linked to each role, and the forces required for each role.
- Australia's *Strategic Review* does not provide extensive public details of defence capabilities, but the Vice Chief of the Defence Force and the Concepts and Capabilities Committee provide guidance on, and endorsement of, Strategic Concepts. These documents, which are used by the Force Development Staff, describe desired outcomes or tasks for the Australian Defence Forces, areas in which they are to be achieved, and the period for which they are to be sustained (that is, the what, where and when).

24.35 Officials told us that, in the current international situation, they do not believe it would be useful to plan against a "threat." However, they agree that policy could state the types and levels of conflict the armed forces are designed for. They said that this approach would be considered in the production of future policy statements.

24.36 Once a national defence policy is in place, military officials must design armed forces capable of carrying it out. This design is called a "defence development plan." Departmental documentation indicates that, during the 1993–94 planning period, senior force development planners found that the existing policy development system did not provide sufficient guidance on the types of conflict the Canadian Forces should be prepared for. Hence they had difficulty in defining the forces that would meet Canada's needs.

24.37 Military planners lack conflict scenarios approved by the Department against which to measure the levels of readiness and sustainment that forces should maintain. Too high a level of readiness increases costs unnecessarily. Too low a level increases military risks. Although planners told us they rely on NATO conflict scenarios, we could not find any written departmental guidance about the levels of readiness and

sustainment for different kinds of conflicts, or any budgetary analysis. We noted that policy statements do not indicate readiness and sustainment goals. The Department has not approved sustainment levels that establish the rate at which the Canadian Forces expect to consume resources during operations.

24.38 The policy process also does not provide planners with priorities. The Department has interpreted as equal the three priorities stated in the 1992 *Canadian Defence Policy* statement.

Affordability is a problem

We found a significant gap between the force structure required to implement defence policy and the funds estimated to be available.

24.39 Policy planners and force developers must estimate the affordability of their policies and plans correctly, or implementing them will prove impossible. Affordability is therefore an important dimension of defence planning.

24.40 Program planners studied the overall affordability of the 1987 White Paper. We could find no affordability studies carried out to support the subsequent 1992 *Canadian Defence Policy* statement. We noted in our 1992 Report that budget estimates had proved to be optimistic. We therefore assessed whether force structure plans aimed at implementing the 1992 *Canadian Defence Policy* statement were affordable. We found that a significant gap remained.

24.41 The Department costed only those activities and projects it had already approved, rather than all those regarded as necessary to implement the policy statement. Some elements of the plan — estimated by the Department to cost over $700 million — were excluded.

24.42 Even with these requirements excluded, plans are not affordable. The 1992 Canadian Forces Development Plan was affordable until the government imposed budget cuts in the December 1992 Economic and Fiscal Statement. The 1992 plan then was short $542 million, or four percent, for each of the first five years, the most reliable part of the plan. The Department was unable to catch up on the shortage, which has continued in the first five years of the 1993 Defence Development Plan.

24.43 Officials told us that National Defence is unlike other departments, in that a large portion of the budget is devoted to the procurement of new capital equipment. When the defence budget is significantly reduced without warning, the only immediate option is to reduce capital expenditure because other means require much longer to take effect. This response to budget reductions continues to be necessary despite the defence policy commitment not to treat capital as a discretionary budget residual. Hence, the capital portion of the budget functions, in effect, as a short–term contingency fund. It also means that "rust out", caused by not replacing old equipment, will continue.

24.44 We recognize that defence planners usually define a shortfall in the resources needed for the full range of activities assigned to them by the government. However, we did not find that the Department has identified the shortfalls clearly, and the risks it is thereby accepting, in its plans or policy statements.

24.45 In its efforts to improve its policy planning process, the Department should include specific conflict scenarios, explicit links between policy and force structure, a full assessment of affordability, and readiness and sustainment goals. These elements should be presented in public documents.

Department's response: *DND agrees with the general intent of this recommendation to provide greater detail in policy documents about the kinds of situations that the Canadian Forces must be able to deal with. Affordability will continue to be a major priority, and program or policy changes will be made if and when appropriate.*

24.46 The Department should revise its management manual to reflect its actual policy planning process.

Department's response: *The Department does not control the process whereby policy is set. The actual policy planning process is primarily determined by the Minister and Government. Departmental manuals will be regularly updated to represent it as accurately as possible and capture innovations and departures from past practice.*

The Quality of Submissions to Senior Management for Decisions Is Not Always Adequate

24.47 Plans are translated into action through a continuing process of management decisions. The Department of National Defence manages through a hierarchy of senior management committees, by means of which most important decisions on resources and policies are made. Accountability also is exercised through that committee structure.

24.48 We selected a random sample of 15 issues, from a population of about 500 that the senior management committees considered between 1989 and 1993. We audited those issues for the quality of the information and the options presented to management for decisions, the timeliness of the total process, and

Exhibit 24.2

Management Issues Studied

Issue		Description	Materiality
1.	Cyclical Review '90	Budget and force review	$6 billion
2.	Land Force Equipment Plan	Budget and force review	$5 billion
3.	Operational Review '92	Budget review	$1 billion
4.	R&D Program	Annual budget	$250 million
5.	Construction Engineering Program	Annual budget	$190 million
6.	Goose Bay Security	Operations	$5 million
7.	CF Newspaper	Personnel administration	$3 million
8.	VCDS/DCDS Merger	Organization	N/A
9.	Smallpox Vaccination	Health	N/A
10.	CFAO 20–53	Peacekeeping personnel	N/A
11.	Basic Officer Training	Training	N/A
12.	Reserve Pay on Operations	Personnel	N/A
13.	CF Quartering	Military housing	$12 million
14.	CF18 Squadron Size	Force planning	$645 million
15.	LOGUIDE Approval	Materiel planning	N/A

accountability for the results. The cases we reviewed are listed in Exhibit 24.2.

24.49 We expected that the Department would define each issue, develop a work plan, put someone clearly in charge and present a recommended course of action within the time set by management. This usually was done. However, departmental staff did not provide adequate information for decisions in six cases, all of which involved inadequate cost information (see paragraphs 24.70 to 24.74).

24.50 In only two cases did we find problems of accountability. The Cyclical Review 1990 revealed shortcomings in the Department's ability to analyze budget changes quickly. The Department abandoned the defence planning and force development process and adopted an ad hoc approach. Senior managers were not certain who was co-ordinating staff efforts and how the commands were involved. One senior manager noted that the process provided neither milestones nor feedback systems that would allow senior management to track issues.

24.51 In the case of the Land Force equipment plan, accountability was divided between Land Force Command Headquarters and National Defence Headquarters. The two staffs made different assumptions about the retention of equipment from Canadian Forces Europe, requiring a second iteration of the plan. Divided responsibility for the amount of equipment a unit should have and for operation and maintenance funding also caused delay.

24.52 The Department should improve information presented to senior management for decisions, possibly as part of its "business planning" initiative.

Department's response: *The concept of business planning is currently under development. Its objective is to improve the management of resources, link achievement of objectives to consumption of resources, measure results and establish accountabilities and interdependencies.*

The Department Needs to Improve Cost Information Provided to Managers

24.53 Cost information is an essential element of management. Decision makers need to know how much things will cost in order to compare various courses of action. In business, most accounting systems are designed to provide cost information. However, government accounting systems historically have been designed not to measure cost but to ensure that authority exists for expenditures and that appropriations are not overspent. The Department of National Defence has followed this general principle in the design of its existing financial management system.

24.54 The Department uses its financial information system to record expenditures as goods and services are received. Because time passes between the acquisition of goods and their consumption, the Department relies on a number of other systems and tools to determine total costs.

24.55 The Cost Factors Manual is one of the more significant tools used by the Department. This publication provides a common basis throughout the Department for staff to estimate the costs of personnel, equipment and facilities. The Department recently improved the Cost Factors Manual and it now provides staff with information on both the fixed and the variable costs of ships, vehicles and aircraft. Information on personnel, base support and ship and crew costs has also been improved.

24.56 We assessed the Department's cost management in three ways: we reviewed the Department's own studies and audit reports; we examined its ability to get and use cost information to carry out its Defence 2000 improvement program; and we examined 15 cases presented to senior management for decisions in the last five years (Exhibit 24.2).

Departmental studies report significant problems in cost management

24.57 We noted in the introduction to this chapter that two features of the Department's management system are centralization and complexity. The Department has created many specialized authorities to manage individual functions from Ottawa. The Department's system separates responsibility for military operations from control of resources. We questioned this practice as long ago as 1980, but the Department responded that "operators" should focus on military activity and not concern themselves with the cost of the resources used.

24.58 As Exhibit 24.3 shows, commands and bases consume most of the resources but the costs of those resources are not charged to their budgets. Many departmental reports comment on the problems created by separating authority from responsibility:

- There is little incentive for consumers to be concerned with economy or efficiency.

- An audit of Canadian Forces hospitals commented that, since the hospitals were accountable for only 20 to 25 percent of their operating expenditures, "there were few incentives . . . to minimize costs and/or to generate revenue."

- The May 1993 *Report of the Ministerial Committee on the Canadian Military Colleges* noted that the colleges were severely hampered by an overall lack of cost information. The Committee commented, ". . . it is somewhat difficult to control costs when one does not know what one's costs are. . . [The colleges] do not have the tools to manage dollars."

The Department is taking steps to allocate more resources to the commands, but command officials told us that the present situation provides insufficient incentives to save. In their opinion, such incentives are critical to the success of business planning and related initiatives.

24.59 During our audit, Air Command officials drew our attention to an initiative to provide cost information to managers of resources. The initiative includes the development of a cost information system for Base Construction Engineering, and the Command plans to expand it to cover all functions and all Air Command wings (bases) by the summer of 1995. This will be a significant improvement, but will still not deal with the separation of authority from responsibility.

24.60 The second major problem recognized by the Department is its inability to determine the impact of changes in the operations and maintenance budget on the readiness of

The Department is improving its ability to manage costs, but much remains to be done.

Exhibit 24.3

Responsibility for Acquisition and Use of Resources Has Been Separated

Organization	Financial Management (what they buy)	Resource Consumption (what they use)
ADM (Materiel)	40%	7%
ADM (Personnel)	40%	14%
Commands/Bases	20%	79%

Military colleges lack the tools to manage dollars (see paragraph 24.58).



Officer Cadets march on the parade square at Royal Military College, Kingston, Ontario. Credit: Canadian Forces Photo by WO Vic Johnson



There is little incentive for consumers to be concerned with economy and efficiency (see paragraph 24.58).

Canadian Forces Hospitals, such as the National Defence Medical Centre, have few incentives to minimize costs (see paragraph 24.58).



the forces. This ability is critical to the Canadian Forces as defence budgets decline. Officials told us that, although they are working to improve systems, they can link the budget to readiness only through detailed analyses and "good management practices".

Lack of accessible cost information has delayed cost–reduction initiatives

24.61 The Department of National Defence calls its initiative to restructure and streamline the Department "Defence 2000". According to the Department, Defence 2000 will create accountability–oriented planning and resource management that will link objectives and activities with resources, make costs visible, and identify the results achieved.

24.62 We examined nine Defence 2000 projects, each of which has as an objective the examination of contracting out. We selected three additional projects that had been undertaken to provide better resource management information but that were not part of Defence 2000. Cost–reduction initiatives and whether they are part of Defence 2000 are shown in Exhibit 24.4.

24.63 We focussed on whether existing departmental information systems provide relevant, reliable, accurate and verifiable cost information to support decision making for these initiatives. We also

Exhibit 24.4

The Department Has Been Slow to Implement Cost-Reduction Initiatives

Initiatives	Part of Defence 2000	Recognition of Needs	Project Starting Date	Expected Completion Date	Elapsed Time
Financial Accountability in Individual Training	yes	1982	1992	1996	14
Training Facilities and Functions Review	yes	1982	1992	1996	14
Consumer Consumption Awareness	no	1992	1992	1996	4
Canadian Aerospace Training Project	yes	1993	1993	1996	3
Cost Effective Medical Services	yes	1990	?	?	?
NDMC Medical Management Information System	no	1985	1985	1996	11
CF Health Information System	no	1985	1989	2002	17
Government Furniture and Effects Move Management	yes	1990	1991	1994	4
CF Relocation Programme	yes	1990	1992	1994	4
Transfer of Dependent Education to Local School Boards	yes	1979	1987	1994	15
Base DelegAAT (Delegation to Base Management)	yes	1988	1990	1996	8
Decentralized Management of Health Care Resources	yes	1988	1989	1993	5

assessed whether the projects have met or will meet their original objectives.

24.64 We found that the Department had conducted four of the 12 projects well and that these generally had achieved their objectives. These projects were:

- decentralizing the management of health care resources, which reduced medical inventories from $12 million to $3.5 million;

- completing a study comparing in–house management of moving government furniture and effects with contracting out this service;

- the Canadian Forces relocation program, which will save $7 million a year on moves of Canadian Forces members; and

- the Base Delegation of Authority and Accountability Trial (Base DelegAAT), which has identified more than $10 million in savings at bases in the Canadian Forces Training System.

24.65 The other projects have been less successful, often because the Department could not determine the costs of its own activities. In the four projects described below, the Department had difficulty developing accurate and usable cost information.

24.66 Financial accountability in individual training. Our 1982 Report noted that the Department lacked cost information to support training decisions but was studying the matter. Our 1990 Report noted large discrepancies between departmental costs for technical training and external costs. The Department again told us that it would conduct a cost study. During the present audit we found that, although the Department has the capability to cost individual training courses, it lacks the resources to cost them all. Departmental officials informed us that they are using more cost information in making training decisions, but the rate of application is limited by the rate at which the Department improves its ability to measure its own costs. They noted that, following the implementation of the Individual Training Management Information System in 1996, more extensive and accurate cost information will be available.

24.67 National Defence Medical Centre Medical Management Information System and the Canadian Forces Health Information System. These two projects were begun in 1985 and 1989 respectively, to automate the management of health resources in the Department. In 1992, and again in 1993, internal audits and studies commented on the lack of information on costs and on resource use, which reduced efficiency and made full cost–recovery impossible. These projects are not forecast to be completed until 1996 and 2002, respectively.

24.68 Canadian Aerospace Training project. The Commander of Air Command has the authority to market excess capacity for pilot training to foreign states. To do this, the Command needs to know its own costs. In 1993 the Department estimated the full cost to be about $200,000 per student for basic training and $100,000 for advanced training. However, in 1994 the Department revised its estimate of full costs to $700,000 for basic training and $330,000 for advanced. The Department did not suffer any actual loss, as no training was marketed during the intervening period, but the magnitude of the revision shows a serious problem in estimating costs. We acknowledge that estimating indirect costs in this area is difficult. Officials told us that they are now in the process of introducing new

costing methodology to address the problem.

24.69 All the projects we examined have taken — or will take — lengthy periods to complete. The four successful projects took four to eight years to complete, but the less successful projects are taking much longer. Five of them will take more than ten years (Exhibit 24.4).

Cost information used in major decisions is often inadequate

24.70 We reviewed the quality of the cost information presented to senior management committees in each of the 15 management cases we audited (Exhibit 24.2). In four cases we found that adequate cost information was provided; in four it was not essential to the decision made; and in one, cost was not relevant. In the six other cases, cost was relevant to the decision but adequate information was not provided to decision makers. These cases include:

- a proposal to start a $3 million Canadian Forces newspaper. Although cost studies were done, the resulting information was not presented to management;

- a decision to consolidate basic officer training to eliminate gaps and inefficiencies, made without a cost analysis. The Department significantly reduced the personnel required and shortened the course, thus lowering costs, but no cost impact information was presented to management;

- a proposed change in Reserve pay for operational duty, on which no cost information was presented;

- the decision to increase the size of CF–18 squadrons in Canada from 15 to 18 aircraft when squadrons in Europe were eliminated. The first brief presented to management overestimated savings by 40 percent and an acceptable costing took over a year to develop and approve;

- the Operational Review of 1992, intended to reduce departmental costs by 3 to 5 percent, in which only 12 of 30 initiatives were actually costed. At the time of our audit officials were unable to tell us how much the Department had saved; and

- the Cyclical Review of 1990, aimed at increasing the capital portion of the budget to 30 percent, but that could not establish important operating costs. For example, the Department could not determine how much would be saved by eliminating CC147 and CC115 aircraft fleets from its inventory. Officials could not tell us how much money had actually been diverted to capital spending through program changes.

Important decisions have been made without adequate cost information. Information is not always available.

A common–sense approach is required

24.71 Resolving the cost management problems we have identified will not be easy. A complex, universal cost information system would be costly to develop and would entail considerable risk. Many of our observations can be addressed by the maintenance of local cost information and analysis commensurate with the significance of the management decision to be made. In the end, a common–sense approach is required, employing tools and information that are matched to the job at hand.

24.72 The Department should develop the means to provide cost information to decision makers on a timely basis, concentrating on critical areas first. This is essential to support the Department's proposed "business planning" approach to decentralized management.

24.73 The Department should review its accountability and incentive structure and make changes to promote improved cost management.

24.74 The Department should develop the capability to track the impact of major decisions — especially major cost–reduction initiatives — to ensure that the intended results are being achieved.

Department's response: *The Department has recognized the importance of providing resource managers with the necessary tools to develop cost information on a timely basis to support decision making and track the impact of decisions to ensure that the intended results are being achieved. Recent initiatives include:*

- *"Cost Centre Management", a project in partnership with Consulting and Audit Canada that will provide wing/base commanders with activity–based management information and will provide a link to departmental business plans;*

- *"Individual Training Management Information System", a department–wide system that will provide managers with the ability to determine activity–based costs of all individual training programs; and*

- *development of a system to track resource savings achieved through implementation of reductions announced in the February 1994 Budget.*

Military Performance Reporting Systems Are Not Adequate

24.75 In addition to the cost of resources being consumed by the Department, officials need to know the quality of the forces being created. One of the most important measures is "readiness". Military units spend most of their time preparing for their potential missions, not deployed on operations. It is important, therefore, for military organizations to be able to measure how ready they are so as to ensure that forces will indeed be capable when called upon to perform an operation.

24.76 In the Canadian Forces, the need to monitor readiness is especially important. The Canadian Forces have undertaken an abnormally high level of peacekeeping operations over the past several years that have disrupted training programs. At the same time, the government has reduced the Department's budget and plans further reductions.

24.77 We have commented since 1984 on the need to improve readiness reporting systems. The Department has made efforts to respond to our findings and now uses several methods to assess military operational readiness. The Department has an overall reporting system called the Operational Readiness and Effectiveness Reporting System (ORES). All commands and major support groups use this system to inform the Chief of the Defence Staff about their ability to perform assigned missions and tasks.

24.78 Each individual command has its own system in place. Some have more than one. In addition, the commands may use operational training exercises as another way to assess readiness.

24.79 Our audit examined all these systems. We assessed whether the Department had implemented the systems according to their design and, to the extent possible, whether the data reported to senior commanders were accurate, valid and reliable.

The Department's overall readiness reporting system is primarily subjective

24.80 The Operational Readiness and Effectiveness Reporting System (ORES) requires that each command report to the Chief of the Defence Staff on its level of readiness to meet missions and tasks. The tasks used for reporting are the same as those used for planning in the Defence Development Plan. According to the instruction issued to the commands by the



Systems used to measure the readiness of the Canadian Forces have not been implemented as designed (see paragraphs 24.75 to 24.94).





Vice-Chief of the Defence Staff, current readiness reporting is supposed to be largely quantitative in nature. The instruction provides "guidance" to the commands, which shows quantitative levels that should be attained for personnel strength, personnel training, equipment availability, and materiel availability.

24.81 The tasks the ORES system reports on are very large in scale. The maritime defence of Canada in the Atlantic, Pacific and Arctic Oceans, for example, is a single task. The ORES system reports on whether groups of military units are ready to perform tasks, not on whether individual units have met a unit readiness goal. This requires additional judgment on the part of staff reporting through the ORES system.

24.82 Command headquarters have not given military units lists of essential equipment, personnel and training. Complete lists of the equipment and training required are too extensive for unit commanders to check frequently. Rather than report on the extent to which they meet standards for essential items, commanders report only negative exceptions that appear significant to them. These negative exceptions may be adjusted by more senior commanders who believe that resources exist elsewhere to make good the deficiency. Maritime Command, however, does have a system in place to monitor and assess the priority of equipment and system deficiencies. In addition, up to December 1993, Maritime Command required units to have 100 percent of their requirements and therefore reporting exceptions did not require judgment as to criticality. Maritime Command is now working on identifying critical equipment, training and personnel to meet revised readiness standards.

The reliability of the data in the Department's primary military performance measurement system cannot be assessed.

24.83 The result is that, instead of being primarily an objective and quantitative assessment of current readiness, ORES is mainly subjective. We attempted to audit elements of tasks that commands reported were "ready", but found we could not determine the basis on which subordinate units reported. Except for Maritime Command equipment, we found that command headquarters do not know how units applied complex standards and do not audit or validate those items that units report as satisfactory. Performance and reporting accuracy was partly validated, however, through operational exercises.

24.84 The lack of specified, quantified standards on which commands can base their reports means that we could not assess the reliability of the data in the ORES system. The degree of subjectivity in reporting limits the system's ability to track readiness trends and its suitability to support the Department's efforts in business planning.

Command readiness reporting systems are not being used as designed

24.85 To manage their units, commands must have information in more detail than ORES provides. They therefore maintain their own systems. However, we found that those systems are not fully operational.

24.86 Maritime Command relies on three measurement and reporting systems: the Combat Readiness Inspection, the Operational Readiness Requirements Reporting System, and the Operational Deficiency Reporting System. We found that Maritime Command has not carried out the required Combat Readiness Inspections of entire ships for at least two years. Based on required tests, we estimate that only 75 percent of the

assessments of operational teams on ships were completed.

24.87 Land Force Command does not have a command system for evaluating and reporting on the readiness of units or formations; it must rely on field exercises and on the ORES system. We comment on these below. Land Force Command intends to improve its ability to measure readiness levels quantitatively by introducing collective battle task standards. The Command also intends to publish draft training regulations in December 1994 that will link collective training to departmental goals and to ORES.

24.88 Air Command employs a testing system known as operational evaluation to assess the readiness of its units. We found, however, that the Command does not conduct operational evaluations as frequently as its system requires. During 1992–93 and 1993–94, Air Command assessed only seven of the 22 units subject to operational evaluations. One of the seven units was assessed after the prescribed time period. In addition, we found that only 25 percent of operational evaluations — those relating to Fighter Group — explicitly consider readiness.

24.89 Air Command officials told us that their operational evaluations had not been completed for a number of reasons. They had redesigned their evaluation system, causing a gap in coverage. The Command had permitted Fighter Group to forego evaluations for one year to allow squadrons to recover from the Gulf War and to permit reorganization following the withdrawal of aircraft from Europe. Finally, budgetary pressures forced the Command to discontinue evaluations for four months throughout the Command as a cost–saving measure.

Existing collective training is not a substitute for an assessment system

24.90 None of the commands link operational or collective training to the tasks in the Defence Development Plan. Commands view exercises both as evaluations and training. This means that exercises do not directly assess the ability of the Canadian Forces to perform high–level tasks, but rather components of those tasks.

24.91 Until 1994, Land Force Command did not have standards to use in assessing units. Collective training provides some information on readiness, but Land Force Command staff did not regard existing field exercises as adequate assessments. Unlike the United States Army, the Canadian Forces does not validate land field exercises and therefore cannot assess whether exercises meet operational requirements.

24.92 We also found that, because of increased operational commitments and reduced budgets, the Canadian Forces has not been able to carry out all the major exercises approved by commanders. In 1993–94, Maritime Command completed all approved major exercises, Land Force Command 71 percent and Air Command 73 percent. Overall, the Canadian Forces completed about three quarters of its approved exercises. In addition, for about 24 percent of the exercises conducted, military officials did not complete a post–exercise report documenting the results and the lessons learned (Exhibit 24.5).

24.93 The Department of National Defence should set up an objective, verifiable operational readiness reporting system for the Canadian Forces. Where quantified measures are not appropriate, clear standards for subjective rating should exist.

Department's response: The Department is now undergoing significant shift in focus from micro–managed centrally controlled methodology to delegation and business planning. As operational reporting systems evolve, objective and subjective criteria will be reviewed.

24.94 The Department should do everything possible to complete readiness measurements, operational exercise programs and post–exercise reports.

Department's response: Agree.

Deficiencies Still Exist in Information for Contingency Operations and War

24.95 The final building block of management that we assessed was the availability of information to manage under emergency and wartime conditions. In previous audits, beginning in 1982, we commented that information systems used by the major support functions were inadequate for major contingency operations and war. The Department has undertaken several projects to correct the deficiencies, but critical problems are still unresolved.

24.96 We reviewed three major wartime support functions: military personnel management, materiel support, and medical support. We found the following:

- The Department has been working to upgrade the Military Personnel Information System, the cornerstone of its network of military personnel systems. However, the system is still unable to meet wartime requirements. During the Gulf War, when only a small portion of the Canadian Forces was deployed overseas, the system could not cope with the number of personnel movements. As a result, the system lost track of individuals. The Department was not able to tell us when problems with the Military Personnel Information System would be resolved.

- The Manpower Integrated Distribution and Accounting System (MIDAS), which the Department would use during emergencies and war to track information on establishment and strength and to control the mobilization of personnel, was also inadequate during the Gulf War. Work completed to improve the system has not been fully tested by users. Changes that will allow the system to support limited operational

Exhibit 24.5

Operational Exercises Have Not Been Completed

Commands	Number of Exercises Planned (1993–94)	Number of Exercises Conducted (1993–94)	Percentage of Exercises Conducted (1993–94)	Post–Exercise Reports Completed (1993–94)	Percentage of Post–Exercise Reports Not Completed (1993–94)
Maritime Command	3	3	100%	3	0%
Land Force Command	59	42	71%	28	33%
Air Command	59	43	73%	36	16%
Total	**121**	**88**	**73%**	**67**	**24%**

deployments will not be completed until 1995.

- The data system used to manage Reserve personnel is inadequate for both peacetime purposes and to prepare for mobilization and war. The Department intends to complete corrective action by 1997.

- The Canadian Forces Supply System, which we noted in 1987 was not adequate to support sustained conflict, was inadequate to support a small overseas deployment during the Gulf War. During the war, users of the supply system did not have timely, up–to–date information on supply. The Canadian Forces Supply System Upgrade project, intended to remedy this deficiency, will be implemented between 1995 and 1998.

- Information systems within the Medical Branch are manual, paper–based, slow and prone to error. Departmental studies have determined that the systems are incapable of expanding to meet the increased workload of large influxes of patients that can occur in war or during emergencies. The Department plans to implement an automated system to correct this deficiency, but not until 2002 at the earliest.

24.97 In addition to the problems described above, our audit found that command and control information systems used to manage and manoeuvre in the field have generally not been designed to operate with each other. Sea, land and air elements would therefore have difficulty communicating quickly and easily. The following chapter describes this problem more fully (paragraphs 25.26 to 25.37).

24.98 Progress has been slow in correcting deficiencies in information for wartime. We found that the time taken from recognition of the need until the planned delivery of the required system is more than 10 years.

Overall Conclusion

24.99 Policy and force development processes need to be improved and readiness reporting systems need to be strengthened. The most significant problem in the defence management system is the lack of adequate cost information on which to base decisions. The Department has initiatives under way to address many of these problems.

Chapter 25

National Defence

Information Technology

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National Defence

Information Technology

Assistant Auditor General: David Rattray
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Main Points

25.1 The Department of National Defence spends 30 percent of the federal government's information technology budget. The total annual cost of information technology in National Defence is $630 million. The information technology projects planned or in progress in the Department's 15–year plan are projected to cost $9.5 billion.

25.2 Military command and control information systems used to manoeuvre forces in the field have not been developed in a co-ordinated way. Sea, land and air systems have not been designed to work together and have little capability to communicate with each other. Existing interim Land Force systems have limited capability for survival on the battlefield. Development work has been duplicative.

25.3 The systems and processes the Department uses to manage information technology are not adequate. Information technology projects take an average of seven years to complete after funding is allocated. With the current rate of change both in technology and in defence, there is a high risk that the technology acquired will be obsolete before it is implemented.

25.4 There are plans for future information technology projects with projected costs of $1.2 billion that are not supported by adequate cost estimates or for which the need has already been filled by other means.

25.5 Although we recognize that military operational requirements take top priority, we found that the Department did not have an adequate system in place to assess the cost-reduction potential of information technology projects or to weigh the benefits of cost reduction against other priorities. As a result, the Department has not benefited from at least $700 million in possible savings. Reduction in support costs would allow funds to be redirected to meet other military requirements.

25.6 The Department has experienced difficulty in implementing complex, developmental information technology projects. Of 12 projects we examined, three failed to deliver an adequate product. A fourth project has expended most of its contingency fund before beginning the most complex development phase, while a fifth has spent 10 years and over $52 million in the project definition phase. These five projects account for 93 percent of the total value of the projects in the sample.

25.7 The delivery of computer and telecommunications services is becoming more efficient, but much more remains to be done. The Department plans to eliminate one of its two major data centres and has reduced telecommunication costs by about $10 million a year. Although the Department recognizes that millions could be saved each year in telecommunications, adequate plans are not in place to realize those savings. We estimate the savings at over $30 million per year.

25.8 The Department is increasing its use of modern techniques and tools to maintain its computer software.

25.9 The Department recognizes that it must change its approach to information technology and has set up a Defence Information Services Organization to manage that change.

Background

25.10 The Department of National Defence is the largest department of the federal government. It manages and controls military operations through systems that employ about 11,000 people in major headquarters alone. Almost 8,500 of them work in National Defence Headquarters.

25.11 These individuals, and an additional 90,000 military and civilian personnel who serve at bases or in operational units, are supported by complex networks of computers and telecommunications through which information is obtained and orders are passed. The Department operates over 600 systems that run on 22 mainframe and mini–computers. It also has over 600 multi–user computers, over 4,000 non–programmable terminals and approximately 45,000 personal computers.

25.12 Telecommunications are also part of the information technology base. The Department employs almost 4,000 people in maintaining the defence strategic communications infrastructure. In addition, it spends $110 million each year to lease telecommunications services from the private sector and other government agencies. It uses more than 50,000 telephones, and maintains seven national voice, video and data systems and



In July 1994 the Department put a Defence Information Services Organization in place to better manage information technology (see paragraph 25.16).

networks. Most of the telecommunication links formerly provided by more than 3,000 lines are now made through a single survivable network.

25.13 The Department's total information technology base of computers and telecommunications systems employs almost 8,000 people, including about 2,500 part–time Reserves, and costs approximately $630 million each year to operate. The Department's information technology capital projects planned or in progress are projected to cost $9.5 billion over a 15–year period, of which $2 billion will be for telecommunications. National Defence accounts for 30 percent of the federal government's spending on information technology.

National Defence spends 30 percent of the federal government's information technology budget.

25.14 Much of the information technology in place is outdated, representing obsolete concepts and technology. Many major data processing systems — including the financial, supply and personnel data systems — are centralized, national systems running on large mainframe computers. These "stovepipe systems" were designed to meet specific functional needs and they operate independently of each other. There is great difficulty in matching data from one stovepipe system to another. File structures in the systems make it difficult — and sometimes impossible — to extract and match data to do required work.

The Department is taking steps to remedy long–standing problems by creating a Defence Information Services Organization.

25.15 Until July 1994, six major organizations in the Department shared responsibility for information technology:

- the Vice–Chief of the Defence Staff provided information holding and telecommunications policy, operational direction, procedures and standards;
- the Assistant Deputy Minister (Finance) provided data processing and office automation policy, standards, planning, operational direction and support services;
- the Assistant Deputy Minister (Materiel) provided research and development, engineering, procurement and maintenance services;
- the Assistant Deputy Minister (Personnel) and the Canadian Forces Training System provided training policy, standards and services;
- the Deputy Chief of the Defence Staff administered security policy and standards; and
- Canadian Forces Communication Command operated the departmental telecommunications backbone and provided signals intelligence.

25.16 In July 1992 the Department undertook a general study of communications and electronics to decide if it could establish a more efficient and effective organization. Following the recommendations of this study, the Department established a Defence Information Services Organization in July 1994. The Defence Information Services Organization combines many previously separate components of information technology management under the direction of a senior military official. The Deputy Chief of the Defence Staff and the Assistant Deputy Minister (Personnel) remain responsible for security and training, respectively, and the Assistant Deputy Minister (Materiel) has retained some procurement and engineering functions.

Previous Studies

25.17 Previous audits have commented on the Department's management of information technology. In 1984 we found that there was no strategic plan for data processing and that major systems were not cost–effective. In 1987 we

reported that the highly centralized supply system was unsuitable for war and did not support efficient management of materiel. In 1990 we found that similar problems existed in human resource management information systems. Our 1992 chapter on the management of capital projects reported that the program and project management systems were slow and unstable. We also found that the systems provided insufficient information to managers, while creating an enormous burden on staff.

25.18 The Department's 1993 communications and electronics study also reported significant problems. The report cited compartmentalization of information technology management; slow and unsuitable processes for managing information technology; and technology that was obsolescent, costly to operate and maintain, sometimes redundant and often unrelated to user needs.

25.19 The Department's study recommended the reorganization of information technology management, and several other significant changes that the Department has accepted and is working toward. Those changes include cancelling several information technology acquisition projects; modifying the acquisition process to allow for earlier involvement of contractors, thus lowering the risk of costly changes when contracts move from planning to implementation; and recognizing the need to eliminate stovepipe data systems that limit the Department's ability to link data bases to each other, especially data on costs and activities.

Audit Scope

25.20 Our audit objectives were to assess the economy and efficiency of information technology use in the Department of National Defence and compliance with Treasury Board directives.

25.21 Our audit included all information systems acquired and all initiatives begun since 1988, general–purpose computing, military command and control and telecommunications. We did not include information technology embedded in weapons systems, such as target acquisition and flight control computers on the CF–18 and computers used in the guidance and electronic countermeasures systems of individual weapons.

25.22 We audited the Department against Treasury Board criteria for the management of capital projects, along with other specific criteria included with the findings below.

Observations and Recommendations

25.23 This chapter presents our findings as they relate to three different levels of management. The first, and most senior, level (referred to as Program Management in paragraph 25.38) is the information technology program, where managers make strategic choices and allocate resources throughout the Department. The second level (called Project Management, paragraph 25.61) refers to individual projects, where users and technologists design and acquire individual systems. The final level (Operations Management, paragraph 25.76) relates to the in–service use of information technology throughout the Department, including stand–alone computers, local area networks, major data centres and telecommunication systems. We also assessed as a special subject the Department's progress in

Previous audits and departmental studies have generally found information systems inadequate and information technology management systems ill–matched to the technology itself.

developing military command and control information systems, due to its importance (paragraphs 25.26 to 25.37).

25.24 Our audit indicates that there are significant problems with both program and project management. These problems stem from the absence of an effective central manager for information technology. Such a manager would establish an overall strategy that addresses departmental priorities, set rules for buying and using information technology and provide assistance to line managers and commanders. We found that most individual projects had been managed well, although the most complicated and costly ones experienced problems.

25.25 At the same time, telecommunications and computer operations are becoming more efficient. Individual managers often have been able to improve efficiency within their immediate areas of responsibility.

Command and Control Information Systems

Command and control information system projects have been developed in isolation and have limited ability to interoperate

25.26 Perhaps the most important use of information technology in a defence department is the control of military operations. We therefore examined the extent to which the Department has met its requirements in that area.

25.27 According to NATO, a command, control and information system is "an integrated system [comprising] doctrine, procedures, organizational structure, personnel, equipment, facilities and communications [that] provide authorities at all levels with timely and adequate data to plan, direct and control their activities." Military organizations use command and control information systems to communicate, manage and manoeuvre when deployed in the field. They are vital to commanders' ability to use intelligence data in decision making, to plan, to communicate orders and to obtain feedback from the battlefield.

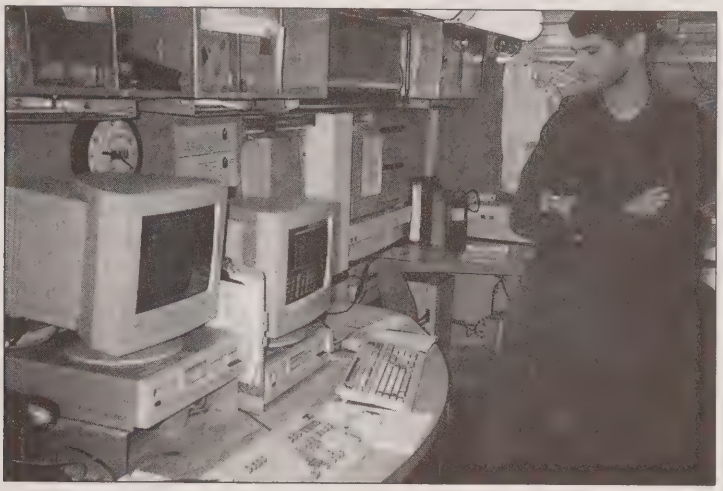
25.28 Command and control information systems are a vital element of warfighting capability. The United States armed services recognized the importance of command and control in their recent operations in Grenada, Panama and the Persian Gulf. The American forces analyzed their shortcomings in those operations and the importance of command and control systems to the Coalition victory in the Gulf War.

25.29 The United States Chairman of the Joint Chiefs of Staff recently published a concept paper entitled *C4I for the Warrior*, intended to solve short–term problems and set long–range goals and strategies. Under that concept, the United States has moved to remedy important problems in duplicative systems, developed by different branches of the armed services, that could not communicate with each other or with allied forces. The American concept establishes a long–range strategy to achieve global interoperability. The goal is to allow commanders at all levels in all armed services to communicate with each other and to access each other's data. The Canadian Forces has no equivalent goal or strategy. The Department is currently working on such a policy.

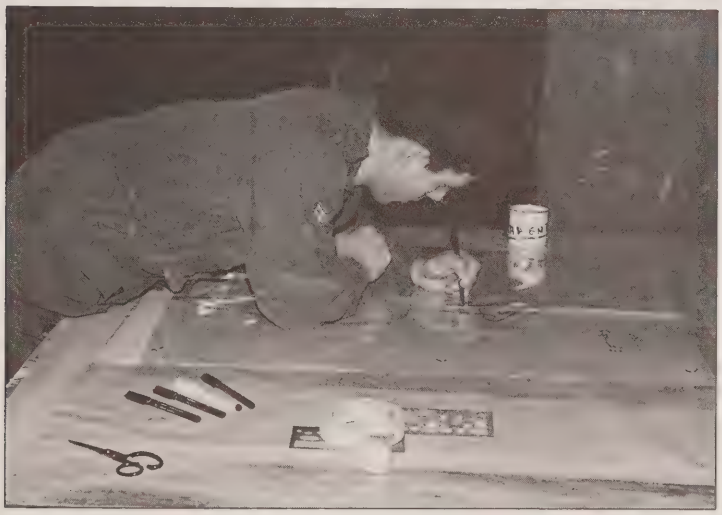
25.30 We examined all command and control information systems being developed by the Canadian Forces. Prior to the 1990 Gulf War, the Canadian Forces planned to operate with allies but with largely separate sea, land and air elements. Although the Gulf War resulted

in the recognition that those elements must work together, we found that each command was developing its own system in almost complete isolation. Existing systems often pre–date the recognition of technology that allows interoperability and of the need for it. In addition, National Defence Headquarters and the Intelligence Branch were developing unique separate systems. Land Force Command has acquired two systems based on different computer–operating system software and is attempting to merge them into an interim Land Force system by March 1995. The Land Force is working on another project to develop a system for the long term. It plans to field this system by 1999.

25.31 Existing Land Force systems have limited battlefield survival capability due to their interim nature and their use in existing vehicles. One of the systems could continue to operate even if individual computers were destroyed, but it is supported on commercial hardware and is vulnerable to heat, moisture, dust and vibration. During recent field exercises it took several hours to set up. The other system uses "ruggedized" hardware, but depends on a central computer that, if destroyed, would put the



The Canadian Forces are automating battlefield command and control...



...but much remains to be done. Here a soldier traces an artillery fire support map by hand during a field exercise (see paragraph 25.32).

entire system out of commission. However, there are backup computers. The central computer is installed in a truck offering minimum protection. Both systems depend on telephone lines to communicate, which are vulnerable to enemy fire. Radio links will not become available for several years, when the Tactical Command Control and Communication System is fielded (see paragraph 25.65).

25.32 The Canadian Forces is fielding several systems that are based on different computer software families and cannot interoperate. There was no central manager of technology to co-ordinate system development and ensure that systems could work together. As a consequence, the systems cannot pass information among themselves, even though their users will be required to work together in joint headquarters. Officials told us that, in the future, the Defence Information Services Organization will provide a central management authority for systems development. Efforts are under way to merge the development of future command and control information systems.

The Canadian Forces has designed battlefield command and control information systems that cannot interoperate or pass information to each other easily.

25.33 The Department has spent $18 million to date on command and control information systems and plans to spend about $240 million more over the next 10 years. Its plans call for at least four separate systems. Our audit calls into question the viability of project plans that extend over such a long period of time (paragraphs 25.41 to 25.45).

25.34 The Department's projects for command and control systems duplicate each other. The basic functions of all systems — message transfer, message logging, digitized mapping and graphics, and map and graphics transfer — are the same, although the computer screens and graphics used by individual services may vary.

25.35 Although the Canadian Forces have had a policy since 1986 to ensure that users co-ordinate the development of command and control information systems, the Department has failed to enforce that policy. As a consequence, commanders have implemented their own systems. As well, project offices have made few efforts to determine the needs of users in other commands and branches. There is no reason why separate service and branch projects could not use the same approach to architecture and development. Air Command's Battle Management Information System (BMIS) is based on a United States Air Force system that already has marine and land force components, but the Canadian Forces have not made use of these in their development efforts. The Department is now working to integrate command and control systems it is developing.

25.36 The Department should consider using "joint" standards to develop all command and control systems, unless the sponsor can justify doing otherwise.

25.37 Concepts and specifications for new command and control systems should require that they be able to interoperate in joint and combined operations and to survive on the battlefield.

Department's response: *The current situation regarding Command and Control Information Systems (CCIS) reflects the preliminary nature of automated CCIS within the Canadian Forces (CF). As a result of efforts to date by each of the Commands, the focus has largely been on validating requirements and operating procedures via pilot or prototype systems. Joint interoperability has not received a*

high priority in these activities until the recent past.

Joint standards and interoperability (paragraphs 25.36 and 25.37) in joint and combined operations are accepted as mandatory requirements. The Information Technology Infrastructure (ITI) and the Canadian Forces Command and Control Information System (CFCCIS) are both actively addressing these requirements.

In general we believe the current situation reflects the early stages of comprehensive CCIS development. There is significant activity under way to ensure compatibility and operability between these early systems as well as focussing on joint and combined CCIS.

Program Management

25.38 Information technology is a unique resource, found everywhere in modern organizations and affecting basic work and management processes. Special skills are required to create and maintain information technology systems. The technology itself has advanced very quickly, with many products becoming industry standards and then disappearing in less than a decade. The costs of handling an individual unit of information and of performing an individual calculation have continued to drop dramatically. A large organization therefore requires a comprehensive approach to manage its investment in information technology to ensure that critical needs are met and that its money is spent wisely.

25.39 The Department of National Defence is now working on or planning 115 major capital projects of $3 million or more each to acquire information technology. We examined several critical areas of the system used to manage these projects. We assessed the time it takes to deliver products to managers and commanders who need them. We looked at whether senior management has good information to direct and control overall spending. Our audit also examined the degree to which managers take advantage of the cost–saving potential of information technology.

25.40 In 1992 we reviewed the Department's overall program management system for all types of projects. We reported that it was cumbersome and expensive, and ineffective at monitoring projects. Although the Department told us then that the system would be completely revised and significantly improved, we found that very little has been accomplished.

In 1992 we reported that the Department's overall program management system was cumbersome and required enormous staff effort to implement. Although the Department promised reform, it has accomplished little.

The Department takes too long to complete information technology projects

25.41 Information technology advances rapidly, and if projects take too long to complete, plans become outdated and specified equipment obsolete, or even unavailable. The Treasury Board's *Blueprint For Using Information Technology* states that, to reduce risk, development teams should work on short–term projects of four to six months. Short–term projects also ensure stability of work teams, which is important in a military setting where personnel are posted to different jobs at least every four years.

25.42 We examined 110 projects costing between $3 million and $200 million. We found that the average time it takes to implement an information technology project is over seven years. This does not take into account the often lengthy planning period before management approves funding. If the planning phase is considered, information technology projects take, on average, over

On average, information technology projects take over seven years to complete.

14 years to complete. Only six of the Department's planned projects will take less than five years to develop and complete.

25.43 The reason things take so long to accomplish is the Department's management system. It requires a project sponsor to secure management approval for all the necessary funding at the outset. The sponsor must therefore develop complex plans that go far into the future to justify major expenditures. Plans must be submitted to senior management for approval at several phases of the project. A contractor usually is not identified until all the specifications are complete, which leads to further changes and delays. Finally, the posting of military officials from position to position creates turbulence and loss of momentum as old managers leave and new managers learn about the project.

25.44 Many projects could be implemented much more quickly. Some have become obsolete while still in the planning phase. For example:

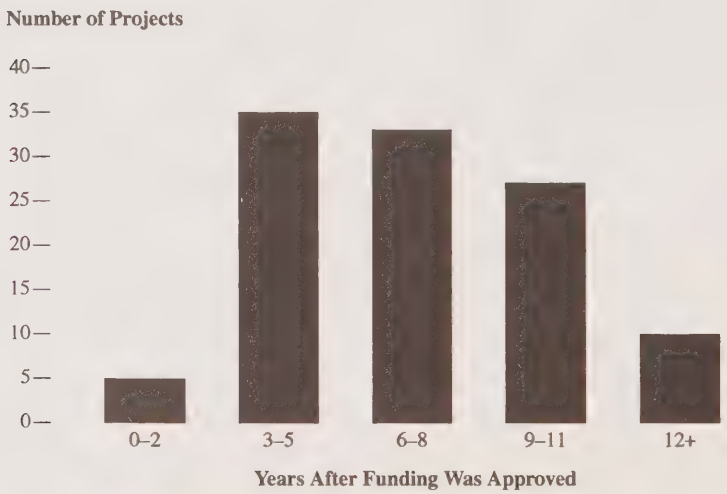
- The Aerospace Engineering Test Establishment (AETE) began a Capability and Facilities Upgrade project in 1982 to improve its existing facilities in Cold Lake, at an estimated cost of $84.8 million. The rapid development of computer technology means that engineering staff need more detailed information to evaluate the performance of newer aircraft, such as the CF–18. Under the current schedule, this project will be put in place from 1997 to 2003, some 20 years after the CF–18 was first introduced.

- The Department began the Military Police System Project to automate the record keeping of service, criminal and other offences committed within DND jurisdiction, as well as the transfer of this information between bases, the commands and National Defence Headquarters and to provide the military police with related automated services. This project had been under study since 1974, and began in its present form in 1989. Its estimated cost is $30 million. After years of slow movement, the Department now intends to implement the project between 1995 and 2000, some 26 years after identifying the need.

- The Department decided in 1977 to provide computers to Canadian Forces bases to automate administrative functions through the Base ADP project. Phase I was to establish a base–level computer

Exhibit 25.1

Information Technology Projects Take a Long Time to Complete



system of six functional management applications, with a total estimated cost of $54.9 million. The first of these was delivered in December 1993, after most of the bases had already acquired many personal computers. Base ADP will have both mainframe and personal computer applications. The Department has decided to end Phase I in 1994 but it is not clear how many of the six functions — beyond the first one — will be operational by then. In 1989, the Department authorized Base ADP II, a separate $20 million project, to provide increased base–level automation over the period 1998 to 2004. We could find no documentation presenting the benefits to be gained from Base ADP II.

25.45 Lengthy delays increase both the cost of projects and the risk to their successful completion. Projects that experienced failure or setbacks because of such delays include the Base ADP Project and the MIDAS project, described in the previous chapter (paragraph 24.96).

Long–range budgets are not adequate

25.46 Senior management must have an accurate view of its information management program. It must be sure that projects it has approved are being carried out, and it must know what funds are actually available to meet emerging requirements. In National Defence we found that long–range budgets are not based on documented analysis and do not provide a firm basis for management decisions.

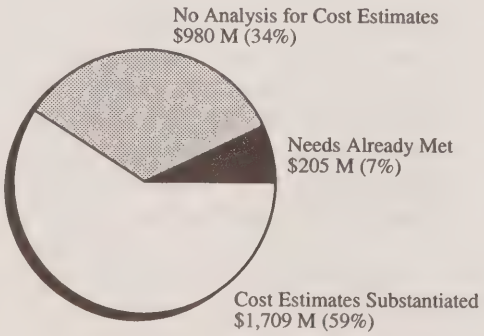
25.47 The Department's program management system requires that funds be forecast for 15 years into the future. Information technology is foreseeable for five years at best. Many of the estimates for projects tying up funds in the information technology program are thus inaccurate or unsubstantiated.

25.48 There are several problems caused by stating cost estimates far in advance of any analysis or study of the requirement and the possible technological solutions. Doing so gives central co-ordinating staff the impression that the requirements for large capital budgets are known years in advance of the planned expenditures. Establishing separate funds for each requirement has the effect of encouraging "stovepipe" solutions, when it would be better to address several requirements through a single project. Finally, cost estimates that are too high can lead to the stretching out or deferral of projects with high cost–saving potential or military value, because the plan indicates that funds are not available for them.

25.49 Staff were not able to explain adequately how sponsors had determined the funding levels for 22 out of 61 projects in our sample. Sometimes not even general assumptions were recorded to explain funding levels. In seven cases, sponsors met requirements by other means, such as spending from the operations and maintenance budget, while they continued to identify the same

Exhibit 25.2

A Significant Proportion of IT Budgets Were Not Properly Substantiated



Information Technology Budgets
Total Budget – $2,894 Million

requirements as capital projects. For example:

- The Aircraft Maintenance Management Information System 2, estimated to cost $7.5 million, has met some project goals using operations and maintenance funding rather than project funding. Project officials told us that they plan to use the saved project funds for software development not included in existing plans.

Lack of a suitable planning approach has resulted in widespread inaccuracies in information technology plans. This can undermine management's control.

- Project officials for the $102 million NORAD Regional Operations Control Centre told us that they cannot determine what the project will cost, since technological choices will be determined largely in the United States and by other factors.

- The requirement for the National Defence Operations Switchboard Replacement no longer exists because of advances in secure telephones, but the Department still lists the project in its program.

- The requirements for the KG34 Crypto Replacement Project will be met completely by other projects, yet it remains in the program.

- The Department has planned since 1982 to build a Land Software Engineering Facility for $7 million. But it also established a Land Software Engineering Centre, funded from operations and maintenance money and money from the Low Level Air Defence project. Since the Centre fills the requirement identified for the Facility, the Department now plans to use funds in the original Facility budget for workstations.

We estimate that $1.2 billion of the $3.2 billion worth of current information technology projects listed are not supported by an adequate plan, or else the need has already been met by other means.

25.50 The requirement to forecast funding needed 15 years into the future, called for by the Defence Program Management System, does not appear suitable for information technology projects. The main problem is that, due to uncertainty about technical advances and about the projected size of National Defence, it is not clear how much future hardware will cost, what software will be commercially available, or who will use the products. Hence it is not realistic to produce more accurate estimates.

25.51 With inaccuracies so widespread, senior management does not have a clear idea of how projected funds will be spent. In these circumstances, program control is undermined and can become ineffective.

The program management system does not adequately take cost reduction into account

25.52 In the Canadian government, cost reduction and cost containment are important departmental priorities. This is especially the case in the Department of National Defence, whose budget underwent a major reduction in 1994. At that time, the Minister's budget impact statement said that the Department would "attack overhead", but did not mention the use of information technology. Our audit shows that there are information technology projects with great potential to reduce operating costs, but these are not adequately taken into account.

25.53 The Department of National Defence naturally places its first priority on ability to conduct military operations. Nevertheless, failure to reduce support costs over the long run decreases that ability by diverting funds from operations to overhead. What is required is an approach that fully assesses all the costs and benefits of projects so that

short–range and long–term benefits are balanced.

25.54 Until January 1994, cost reduction was not a priority in the selection of information technology projects. Since then, the Department has recognized cost savings as a criterion in selecting projects to fund but allows it only 3 of 15 points in the priority ranking system, no matter how much money could be saved. A system with arbitrary point limits is unlikely to assess management trade–offs correctly.

25.55 Moreover, there were problems with the way the new system was implemented. Program managers did not provide adequate guidance to project staff on how to determine the potential for cost savings. Projects where potential savings were not fully defined did not receive even the three points allowed for cost–reduction potential, including a case where the benefits were very promising. Senior managers complained that the point rating system was inaccurate, and had to renegotiate to determine which projects should be given priority. We found that the full magnitude of estimated cost savings was not presented to senior management for some projects. We could not find any documentation to support the lower estimates presented.

25.56 Our sample of 61 projects — over one half of the entire information technology program — contained 11 that project offices believed had potential for significant cost savings but that were not implemented as quickly as the potential savings might appear to warrant. According to the estimates of project officials, implementing those projects on a priority basis would have saved at least $700 million. The projects included the following:

- The Land Engineering Maintenance and Operations System (LEMOS), designed to allow the Land Forces to manage their extensive fleets of vehicles better. The project will cost over $20 million and the sponsors estimate that it will permit them to reduce operations and maintenance costs of vehicles by 10 percent, or $25 million a year, and of the system itself by another $3 million a year. The project also would allow the Department to adopt Computer Aided Logistic Support, which officials estimate could save an additional 15 to 20 percent of the Land Force capital budget, or $115 million each year.

Officials believe the LEMOS project would save at least $28 million each year, and the technology on which it is based is well known. Although the project office estimates that the project could be carried out in four to five years, the Department will not complete the project for 14 years. According to departmental plans, the project will wait eight years for funding and then be implemented over an additional six years.

The Department has given low priority to projects that could save millions annually.

- The Naval Maintenance Management Information System, which will link existing naval maintenance management systems with information on cost and performance. The Department has estimated the cost–reduction potential of this project to be at least $9 million a year, but it is not scheduled to be completed until 2001.

- The Computer Assisted Electronic Training Project, which project officials estimate will cost $16.5 million. This project could save money by reducing travel, the number of course training days required, and trainers' salary costs. Although the Department is now implementing the project, the approval process took three years, foregoing savings of $27 million to $37 million annually.

- The Military Recruiting and Selection Information System, which will

automate current manual processes involved in recruiting and selecting military members. The Department began the project in 1982, but it will not be implemented until 1997, 15 years later. Officials estimate the project could have been developed and implemented in less than four years and that it could save $2.7 million a year, by reducing paper burden and the number of people required to run the selection process. The savings foregone amount to over $30 million.

- The Computer Assisted Publishing and Electronic Records Retrieval System, started in 1992 and intended to reduce the $1.5 million per day the Department spends on computer printouts and other

Exhibit 25.3

Cost-Saving Projects Have Not Been Given Priority

Project Name	Cost $93-94 ($ millions)	Minimum Estimated Annual Savings ($ millions)	Extra Time Waiting for Funding (Years)	Minimum Savings Foregone ($ millions)
Land Engineering Maintenance Operating System	$ 21	$ 28	9	$ 252
Naval Maintenance Management Information System	29	9	6	54
Military Recruiting and Selection Information System	7	3	11	30
Trainee Production Management System Upgrade	6	23	4	93
Computer Assisted Publishing and Electronic Records Retrieval System	54	100	1	100
Strategic Message Switching System	96	25	2	50
Quality Assurance Management Information System	9	11	8	84
Computer Assisted Electronic Training	17	27	3	81
Data Centres Consolidation and Automation	25	5	1	5
Training Performance Enhancement	33	?		?
Information Technology Management Tools	25	?	19	?
TOTAL	**$ 322**	**$231**		**$749**

Note: Numbers have been rounded.

paper records. The Department has estimated that more than $100 million per year could be saved, but a pilot project scheduled to begin in 1993 has yet to receive funding. The project has been delayed because of staffing problems and because of increased emphasis on management of information holdings. However, the Department did not assess the costs of delay versus the benefits of further study.

There is little duplication of effort

25.57 We assessed projects in our sample to try to determine the extent to which they duplicated the development or results of other projects. Although there did not appear to be any central assessment of projects for duplication, we found that project directors are able to co–ordinate their work. We found only four projects that appeared to duplicate each other significantly.

25.58 The Department has undertaken two projects to provide pay services to the Reserves. We estimate the cost of duplication to be $9 million.

25.59 We also found that the Department had a project in place to buy computer hardware for training facilities at Canadian Forces Base Gagetown, although the Base already had some of the necessary hardware. During our audit, the Department acted to avoid the potential duplication and no loss occurred.

25.60 The Department should re-examine the way it manages its information technology program. It should:

- **ensure that the new Defence Information Services Organization will be accountable for the information technology program as a whole, including providing strategic direction and clear guidance for managers;**

- **ensure that the guidance established for individual projects does not require longer–term planning than is practicable, and guard against**



Projects aimed at saving money by reducing paperwork have suffered delays. These technical manuals for the Challenger jet have been replaced by a single video disk (see paragraph 25.56).

retention of funds for which firm plans do not exist and against duplication of effort; and

- **develop and implement a system to give appropriate priority to projects that will reduce costs. This system should include analysis of the business cases for information technology projects and incentives for managers to implement cost savings projects.**

Department's response: *The criticisms of information technology (IT) project management are generally accepted as valid and are being addressed in a variety of fora both within DND and in co-operation with central agencies and other government departments.*

On the first point: The approval to create the Defence Information Services Organization (DISO) focussed primarily on the need to establish a single organization having the authority and accountability for the overall IT program. The DISO has as a priority objective the approval and promulgation of the overall Information Management (IM) Policy and implementation strategy. Concurrently, strategic planning activity is under way to ensure IM/IT strategies are aligned with DND/CF missions and roles, and that these strategies are reflected in associated standards, plans and directives.

On the second point: It is difficult to reconcile the recommendation with the requirement to at least identify individual project areas in the 15–year Defence Services Program (DSP). It is accepted that initial estimates must, by their very nature and the pace of technological change, be very approximate. We are committed even in current practice to a regular review and refinement of such estimates as projects approach the substantive approval stages.

On the third point: The co-ordination of Information System and Management Plans with a comprehensive business plan will contribute significantly to the identification of opportunities for major cost and effectiveness improvements, and thus the development of formal business cases to justify strategic investments, and an accountability framework to assist in verifying results.

The lengthy planning and approval process has been widely recognized and numerous studies and trials related to the overall Defence Program Management System (DPMS) and specific project areas have been initiated to achieve major improvements. It should be recognized and accepted that the 15–year planning data must of necessity be approximate and subject to refinement and verification throughout the steps leading to project approval.

Project Management

25.61 As well as managing information technology at the strategic program level, government departments also need to manage the acquisition of individual parts of their programs. In the federal government, this is usually referred to as "project management", which includes the development, acquisition and installation of individual information technology systems. The systems may involve hardware, software or applications, but usually all three.

25.62 The Department of National Defence has over 40 projects in progress valued at $2.9 billion in its program to provide general–purpose computing and telecommunication services. We selected a random sample of 12 projects completed or initiated since 1988. Those projects and their estimated costs are listed in Exhibit 25.4.

25.63 Our audit assessed whether the projects produced results as specified in their plans within agreed time and costs, whether they met Treasury Board criteria for the management of capital projects, and whether they followed the "best

practices" of the information technology industry. The criteria included having a clear definition of what the product is supposed to do, considering the costs and benefits of all the reasonable alternatives, staffing the project office with qualified people, ensuring that managers know what they are responsible for, and breaking the work into manageable units.

25.64 Seven of the 12 projects met our criteria. They were primarily hardware purchases with well–defined requirements, and were relatively uncomplicated to put in place. However, the seven projects accounted for only 7 percent of the value of the projects in our sample.

25.65 The other five projects, comprising the other 93 percent of project value in our sample, failed in some significant way to meet our criteria. They tended to be more complicated development projects that would directly affect how work was carried out by large numbers of people.

- The **Tactical Command, Control and Communication System** (TCCCS), a $1.9 billion project intended to provide a modern Land Force battlefield communication capability, is at risk. Prior to government approval, the Department changed the definition of requirements several times to respond to budget changes. The project office is completing detailed definition work during the implementation phase. The project office committed 70 percent of its entire contingency fund of $170 million and has earmarked the balance to pay for engineering change proposals and foreign exchange fluctuations, even though the most complex segment — the design of software to integrate the communication system — is only 10 percent complete and eight months behind schedule. Slippage will require the project office to remain in place at least a year beyond the original plan, at a cost of almost $1 million per month.

The project will not deliver integrated logistics support by the time the first radios arrive. We have found in the past, as noted in our 1990 chapter on military

Exhibit 25.4

Projects in Sample

Name of Project	Estimated Cost ($Millions)	Type	Met Criteria
TCCCS	$ 1,899.5	Communication	No
CFSS Upgrade	291.0	ADP	No
Military Aeronautical Communication System	29.5	Communication	Yes
Base ADP	55.6	ADP	No
Line of Sight UHF Replacement	18.9	Communication	Yes
Integrated Data Network (IDN)	58.2	Communication	Yes
Central Computational Pay System	27.0	ADP	Yes
MPIS Upgrade	4.8	ADP	No
FIS MK III	7.1	ADP	Yes
Joint DDDS/ORAE Computer	16.9	ADP	No
DCB Hardware Replacement	10.2	ADP	Yes
Teletype Fleet–Life Extension	4.5	Communication	Yes
TOTAL	**$ 2,423.2**		

training and our 1992 chapter on the Canadian Forces Reserves, that this results in extra cost to the government.

The project will not supply enough radios to fully equip all Land Force units. The Department regards the project as the minimum requirement. Any cost overruns that cannot be funded, therefore, will require offsets from elsewhere in the communication system or reductions in integrated logistic support.

- The **Canadian Forces Supply System Upgrade** is a $291 million project designed to correct problems in the existing national system of supply management. The Department began working on this project in 1985 and has already spent about $52 million to define requirements and select a contractor — over $16 million more than originally planned. It expects to award a contract to a private sector software developer in late 1994. The Department and the contractor are working on a "bridging phase", during which they are revising the performance specifications for the system and negotiating terms of the contract.

The Department approved the project based on operational needs, but did not undertake a full cost–benefit analysis. Potential benefits of the project were not quantified until this year, five years after the start of detailed project definition studies and the expenditure of 17 percent



The Tactical Command Control and Communication System (TCCCS) project, which will replace the old field radio shown, is at risk (see paragraph 25.65).

of project funds. The project is now more than three years behind its original schedule.

- The **Base ADP** project is described more fully in the box below. In general, the project has taken more than eight years to complete, has suffered overruns in time and cost and has not delivered the products included in its original objectives.

- The **Military Personnel Information System** upgrade project is designed to correct long–standing deficiencies in that system (see Chapter 24, paragraph 24.96). The Department has spent $3.8 million on hardware and two software applications, but the deficiencies have not been corrected.

- The **DDDS/ORAE Computer** project was intended to provide specialized support to departmental graphic artists and operations researchers. We found that requirements were not completely and adequately defined and that project staff did not do an adequate options analysis or risk assessment.

As a result, this $16.9 million project did not provide a usable product to the graphic artists. The operations researchers scrapped their system five years after project completion.

25.66 Our audit shows that the Department did well when purchasing hardware to meet well–defined requirements. It has experienced the most difficulty in delivering software development projects. Overall, we found that requirements definition and options analysis need to be improved.

25.67 We expected to find a full cost–benefit analysis of all reasonable alternatives that could satisfy project requirements. We expected these analyses to include quantified performance and cost factors, as well as "soft", difficult–to–measure costs and benefits. We found in the group of projects that did not meet our criteria that the level of analysis was poor. Options analyses were mostly qualitative and used order–of–magnitude cost estimates. The options for the TCCCS project, valued at $1.9 billion and aimed at equipping the entire Land Force, were assessed on qualitative aspects only, not on hard performance or cost. The benefits of the $291 million supply system upgrade were not assessed before the project was approved.

25.68 The lack of user involvement throughout the project life cycle increases risk, as do development methods that require user representatives to develop requirements and hand them over to a project manager, who then defines the system needed and in turn hands the completion of the project over to a contractor. This method does not meet "best practice" criteria. The information technology industry prefers a higher level of user involvement, based on small modules that allow for evolutionary development of a large system.

25.69 The two cases presented below contrast the two approaches. The Department has not yet fully incorporated evolutionary system development in its project management system, although it has taken steps in that direction. System developers must go around the program management system to apply evolutionary system design. On occasion they do this by funding projects as "operations and maintenance", which calls for less stringent control. Use of operations and maintenance funding defeats the goals of the project management system and may leave associated logistic requirements

System developers must go around the project management system to use evolutionary development techniques that the information technology sector considers to be "best practice."

unmet because there is an assumption that operations and maintenance projects do not need to address logistics.

25.70 We found that senior project staff often lacked appropriate qualifications and experience in system development. This contributed to the problems encountered by Base ADP and the DDDS/ORAE Computer, and to the delays in the development of the requirements for the supply system upgrade.

25.71 Also, military personnel change jobs frequently. The larger, longer projects each had, on average, three managers and four directors. The impact of turnover could be reduced if projects were designed in modules that could be completed during the tenure of a single manager.

25.72 The Department should normally use an evolutionary approach to developing information technology projects rather than attempting to deliver the complete system by the existing method, which takes years to put a product in the users' hands.

25.73 The Department should ensure that capital projects are approved only after adequate options analyses have been completed.

25.74 The Department should take steps to ensure that directors and managers of information technology

Exhibit 25.5

The Battle Management Information System — Appropriate Project Management

The Battle Management Information System (BMIS) is the system that Air Command uses to provide commanders with graphic displays of radar–detected air movement, coverage and operational status of radars, and readiness of aircraft. It also provides summaries of airfield status, air transport scheduling assistance, and secure office automation, including secure message transfer. BMIS is the key system for fusing battle management data into a single picture for commanders in Canada and those deployed overseas.

Air Command has developed and fielded BMIS through a series of small projects. It expects the entire system to cost about $17 million when complete. The project appears to have been successful to this point. The reasons for this success are the following:

- The **adoption of an existing, suitable system**. Air Command did not attempt to "reinvent the wheel". Air Command developers adopted the Command Tactical Information System developed by the United States 11th Air Force, which they found met most of their requirements. The 11th Air Force provided computer codes at no cost to Canada and formed a development consortium with Air Command to improve and expand the system.
- **Use of an evolutionary approach**. Air Command began on a small scale and developed modules quickly. Developers could control their projects and meet user requirements.
- **Significant user involvement**. The main client, Fighter Group Headquarters in North Bay, drove the development priorities and was involved throughout. The major complaint to date has been that the developers could not supply application modules fast enough.
- **A stable development team**. The Command built up a development team in Winnipeg that had one officer in charge over the first three years of the project's life.

The BMIS development was not perfect. Project success has sometimes been achieved at the expense of program control. Developers went outside the program management system, building their system with operations and maintenance funds, and the project office has not yet met important requirements such as documentation and logistic support. However, BMIS has delivered a workable system in a short time at a reasonable cost. Officials told us that the Department is now considering possible ways of improving flexibility and speed while ensuring that the entire requirement is met.

projects have system development qualifications commensurate with the size of the project.

25.75 The Department should ensure that, to the maximum extent practicable, project staffs are stable throughout the project's life. It should break large projects into smaller, more manageable units that can be completed during the tenure of a single manager.

***Department's response**: A major change has been instituted to streamline project management by creating a directorate that has the mandate to direct projects from the acceptance of an initial requirement through to system delivery. It is anticipated that this will improve continuity and understanding of requirements, and provide greater flexibility to adapt to changing requirements and to implement early capabilities.*

In co-operation with central agency and departmental program management authorities the Defence Information Services Organization is actively investigating evolutionary and modular approaches to systems delivery that fully involve the user, but maintain the required accountability framework (paragraph 25.72).

The recommendation concerning options analyses (paragraph 25.73) is agreed and

Exhibit 25.6

Base ADP — Inappropriate Techniques

Base ADP is a project intended to provide Canadian Forces bases with information technology to support a wide range of administrative and support functions, including construction engineering, military and civilian personnel management, workshop management, transportation operations, and base pharmacies. The Department approved the project in 1981 but funding was not available until 1986, when Treasury Board approved $55 million for the project. In 1994, eight years later, the project is still trying to complete its products.

The project has not been successful. At the time of our audit, most of the application modules were behind schedule and over budget. For example, the construction engineering module was 22 months behind schedule and 10 percent over budget; the military personnel system product was rejected as unacceptable and now will be about two years late; to minimize costs the civilian personnel administrators withdrew from the original project and substituted another existing system; the pharmacy module is two years late; and the workshop module is a year behind schedule and $500,000 over budget. In addition, the transportation operations module was designed to operate on a large computer, but the project will deliver personal computers. The sponsor likely will scrap the module.

The reasons for these problems are as follows:

- **Inadequate user involvement**. Base ADP represents an old approach to development that involved users closely only during the first stage of the project. The project office developed the requirements in the early 1980s through surveys, interviews and site visits. That version of the requirements was the basis for the project approved in 1986, although user needs had changed due to technological advances and operational changes.
- **Lack of suitable development methodology**. The project office used a system development method that, although accepted in its day, further separated programmers from the functional users by requiring them to work from a specification rather than directly with the user.
- **Contract deficiencies**. The contract lacked penalties for late delivery of work; there was no provision for approving changes in contract staff; and there was no mechanism for consultation with the contractor to clarify requirements.
- **Weaknesses in the project team**. Many key staff lacked prior experience in project management and systems development. The project office had a high turnover in staff.

procedures that already provide for such analyses are being refined to ensure objective assessment of all practical options.

The assignment of appropriately qualified project managers and their availability for the life of the project (paragraphs 25.74 and 25.75) are pursued to the extent possible, consistent with the exigencies of the Canadian Forces and the availability of qualified civilian personnel. The implementation of the evolutionary approach to information technology project development is expected to facilitate modularization of larger projects into more manageable segments.

The recommendations are accepted. Many initiatives are under way to address the noted deficiencies.

Operations Management

25.76 This chapter has so far discussed the overall planning of information technology and the acquisition of individual parts of the information technology base. It is also important to ensure that technology is efficiently and effectively used once it has been purchased and installed.

25.77 We reviewed five aspects of information technology operations: information systems, telecommunications, departmental data centres, local area networks, and application software maintenance. We concentrated on the economy and efficiency of operations.

25.78 We found that here, too, operational efficiency and effectiveness had been affected by the lack of adequate central management of the entire program. However, we did find that individual managers often had been able to improve efficiency within their immediate areas of responsibility.

Most information system users are satisfied, but efficiency problems remain

25.79 Over 10,000 individuals work in major Defence headquarters and use hundreds of computer systems. We surveyed a random sample of 1,600 headquarters staff to find out if they were happy with the information systems they used.

25.80 We found that over 45 percent of headquarters staff use information systems and that over 60 percent of them use the information to perform analysis or to make decisions. About 78 percent of the users of these systems told us that they are satisfied with the information system they use (see Exhibit 25.7).

25.81 Problems affecting efficiency do exist, however. Almost 60 percent of users have not received formal training and about half of them believe that this detracts from their performance. Exhibit 25.8 depicts the reasons why over a third of users feel that their job–related information requirements are not met by the information system they use. Over a quarter find themselves often searching for information to supplement their computer system. We also found that a

Exhibit 25.7

Percentage of Users Satisfied with Information System They Use



minority of about 14 percent are not confident that the data their system provides are free of errors.

25.82 We also found that most of the users who depend on local systems or personal computers input at least some of their data by hand (Exhibit 25.9). More than 20 percent of users of local and personal computers input data by hand directly from hardcopy printouts produced by another computer system. This is costly and negates at least part of the value of the system.

25.83 The Department should ensure that users of information systems are suitably trained.

25.84 The Department should take steps to ensure that information systems contain the data required for users to perform their jobs.

25.85 The Department should improve the transferability of data from one system to another.

***Department's response**: Steps are being taken to improve the availability of individual training in general information technology skills (paragraph 25.83), and to ensure that adequate provision for training is included in capital projects.*

The requirement to obtain required data from more than one source is forecasted to exist for the foreseeable future largely due to the fact that much information is not yet available in an automated form. The ability to access all electronic information is expected to improve dramatically as the departmental information technology infrastructure is fully integrated over the next five years, and data standards are enforced (paragraphs 25.84 and 25.85).

Telecommunications is becoming more efficient, but much more improvement is needed

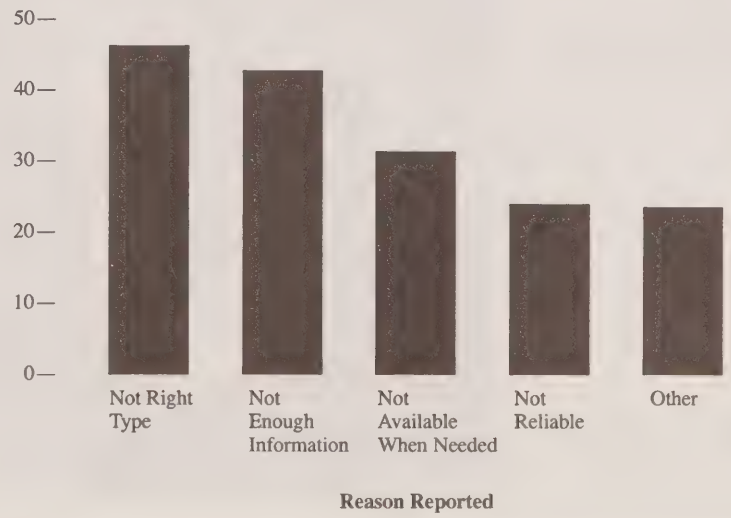
25.86 The Department of National Defence operates seven telecommunications networks. The total cost of operating them was $165 million in 1992–93. About $75 million consisted of personnel costs and the balance of $90 million was spent on leasing services and facilities.

25.87 The Department has reduced costs by about $10 million each year by setting up the Defence Integrated Services Digital Network. However, the full potential of this information network has not been realized because of lack of traffic. Further savings will result as the Department moves more services to the network. This initiative shows that the Department can apply up–to–date and proven technology to reduce costs.

25.88 We assessed the Department's plans for further improvement against a model of what we consider the best use of existing technology. During our audit, the Department identified the major

Exhibit 25.8

Reasons Why Information Does Not Meet User Needs



opportunities for cost reduction in its general plans. We estimate that the initiatives identified could reduce costs by over $30 million each year, but the Department has yet to approve detailed implementation plans.

25.89 The principal opportunity for savings lies in replacing the Strategic Message Switching System (SMSS) that the Department uses to send classified messages and messages that must be logged in as received. The SMSS is obsolete and labour–intensive, requiring over 1,200 people to operate and maintain it. The Department is replacing parts of the system by using operations and maintenance funds, but plans to spend over $100 million before the year 2000 through the Defence Message Handling System initiative.

25.90 However, detailed plans for the implementation of this project are still in draft form. Documentation provided limited information about the impacts on expenditure levels, personnel and operations. The lack of personnel redeployment plans is especially significant, since replacing the existing system with secure e–mail would affect over 1,200 jobs and potentially eliminate many of them. Detailed planning is required where large numbers of positions are to be eliminated and personnel affected. Otherwise, the potential cost reduction is at risk, as is a fundamental improvement in service throughout the Department. Without detailed plans, the annual savings are difficult to estimate accurately. However, using assumptions that we believe to be reasonable, we estimate that the Department could save over $25 million a year.

25.91 We found the situation of the Defence Telephone System (DTS) to be similar to that of the Strategic Message Switching System (SMSS). Voice telephone requirements cost $25 million each year, or about 60 percent of the Defence Integrated Services Digital Network costs, and over 20 percent of departmental telecommunications



We found almost 60 percent of computer users had not received formal training and about half believed this lowered their performance (see paragraph 25.81).

expenditures overall. We estimate that modernizing the DTS could save $5 million a year but, as is the case with the SMSS, detailed implementation plans do not yet exist.

25.92 Besides these opportunities, we identified two other areas where cost savings could be realized. The Department maintains two control centres for the Defence Integrated Services Digital Network and the Integrated Data Network, at a cost of $4.1 million a year. These centres are very similar in nature; consolidating and reducing the staff involved in leasing could save approximately $1.5 million a year. During the course of our audit, the Department began to consolidate the centres.

25.93 The Department is using only 60 percent of the ports and half the volume capacity of the Integrated Data Network. Users have complained about the amount of time it takes to be connected to this service; we found the administrative process to be complex and cumbersome. However, the Integrated Data Network is cheaper to use than the alternatives being used currently.

25.94 During our audit we found that managers frequently had to undertake special studies to answer our questions about the costs of services. Managers agreed that they need this information themselves, and they consider existing systems inadequate to meet their needs for cost information.

25.95 The Department should ensure that plans for the Strategic Message Switching System (SMSS) and the Defence Telephone System (DTS) projects are fully developed and reflected accurately in the Defence Program Management System. The plans should describe benefits, provide accurate estimates of capital and operating costs, provide a detailed implementation schedule and address technical and personnel impacts.

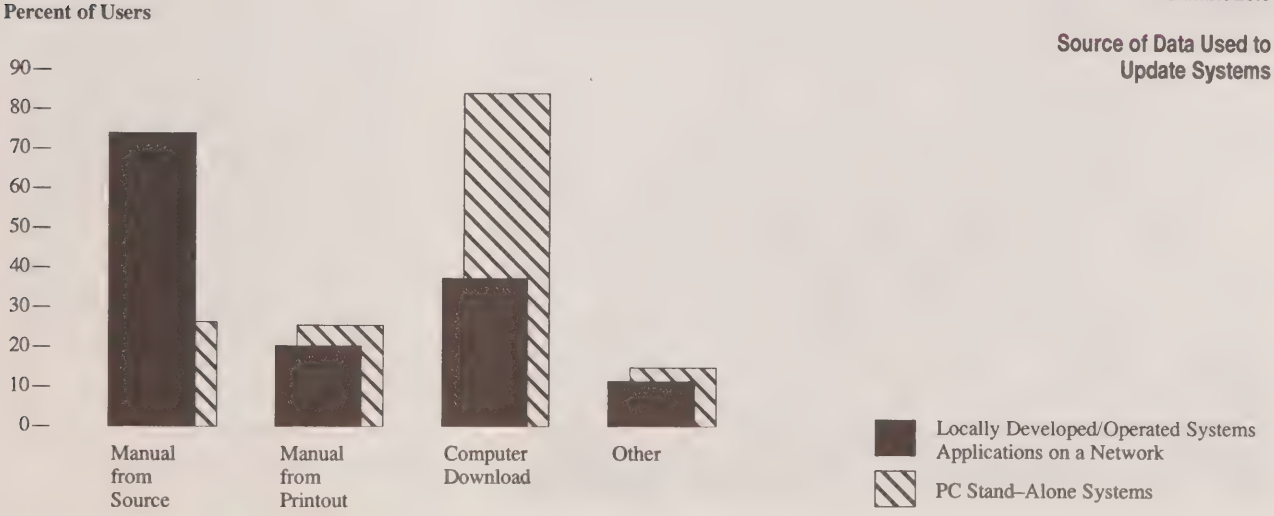
25.96 The Department should reduce costs by accelerating the rate at which users are added to the Integrated Data Network.

25.97 The Department should ensure that adequate information is available to support business planning for the

There is a potential to reduce annual telecommunications costs by over $30 million.

Exhibit 25.9

Source of Data Used to Update Systems



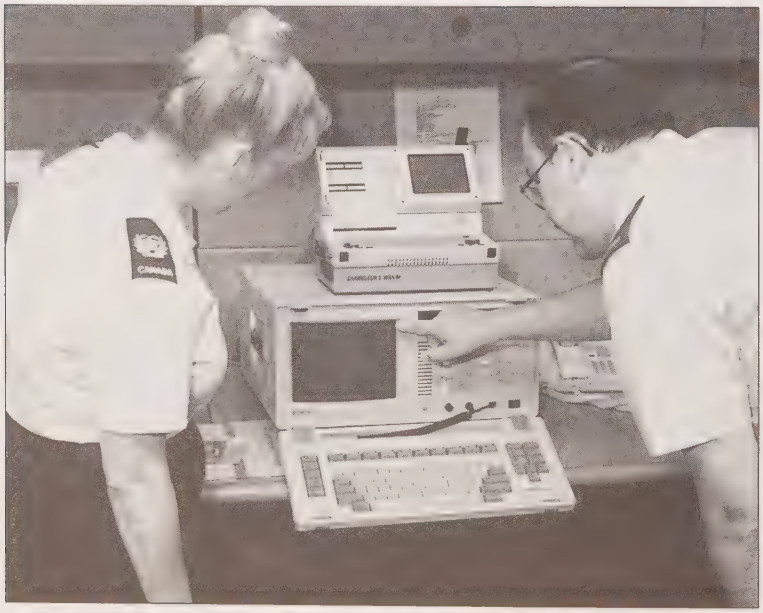
management of telecommunications services.

Department's response: *The Department has assigned a very high priority to the rationalization and integration of all national communication networks, subject to the availability of security products. The resource and schedule implications are being fully defined during the course of this planning and design activity (paragraphs 25.95 to 25.97). These plans and resource requirements will be incorporated in the associated Defence Information Services Organization business plans.*

The Department has improved efficiency at data centres

25.98 At the outset of our audit the Department operated two large data centres: one in Ottawa and the other at Canadian Forces Base Borden. These centres used computer technology dating from the early 1980s.

Telecommunications is becoming more efficient. These technicians are analyzing traffic on the Integrated Data Network (see paragraph 25.92).



25.99 The Department began a study in 1990 to upgrade the data centres, but a cost study was not begun until January 1993 and was completed in December of that year. In January 1994 the Department decided to close one data centre, which will save more than $21 million over the next five years. Delay in acting on this potential for cost savings has cost the Department almost $5 million each year.

25.100 The closure will further improve data centre efficiency.

The Department has not taken full advantage of its investment in local area networks

25.101 Local area networks are computer systems based on connected groupings of small computers or workstations that share software, data bases and network resources, such as printers. Users of local area networks can pass information from station to station or share commonly used data. Networks can be local, in one office or a single building, or can be national in their scope. The Department has linked most of its personal computers in local area networks and plans to create larger metropolitan area networks.

25.102 The Department does not have a complete inventory of its network investment, although in 1993 it began to develop an inventory and intends to complete the project by 1996. Commands and headquarters groups are responsible for the development and management of their own local networks. The Department has acquired at least 500 networks that support about 45,000 users, at a cost of over $135 million.

25.103 In spite of the extent of its investment in modern network technology, the Department has yet to take full advantage of it. Because managers have

developed their networks individually, there has been only limited use of common systems across commands and groups in National Defence Headquarters. Few networks can communicate with each other and there is a risk that some existing networks cannot be linked together. The Department has only recently adopted strategies, policies and management plans to integrate its networks. National projects such as departmental e–mail and the headquarters metropolitan area network are recent.

25.104 The Department has not yet begun to re-engineer its work processes to take advantage of the widespread presence of computer terminals and networks throughout the organization. Some communications capability is in place, such as electronic mail, but the Department has not yet achieved the department–wide interoperability proposed in its long–term plans. We found that there are several different electronic mail systems even within the same Headquarters group.

25.105 As we have noted with respect to the acquisition of major capital items, departmental processes related to the acquisition of the $135 million worth of minor capital items are also inconsistent with the nature of information technology. Approvals for buying equipment involve many people and often take a long time. In one Headquarters group, for example, while most equipment is ordered by users in the fall, purchases are not made until the end of the government accounting year in the spring. Delays in the process deprive users of benefits, may disrupt service support if equipment all arrives at the same time, and can affect warranties because equipment may not be installed when it is delivered. We found that only one information technology manager maintains a workflow system to track technology acquisition and deployment.

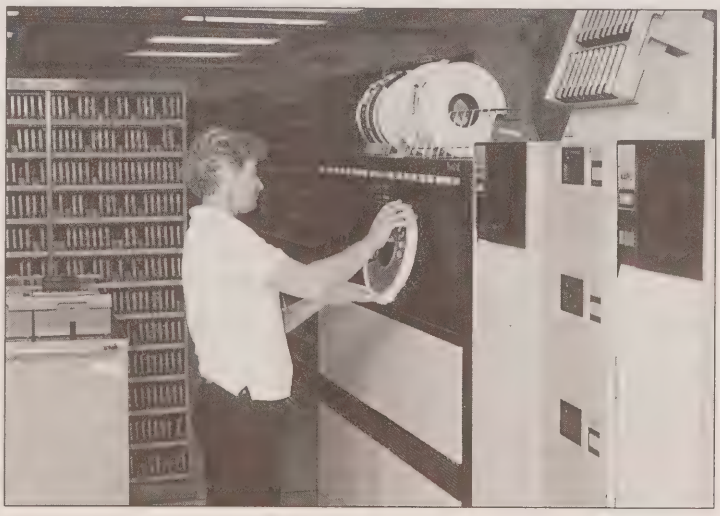
25.106 We noted a wide range in the qualifications and training of network support staff. In some cases, funding has been insufficient to meet the training requirements. Land Force Command officials noted serious deficiencies in the qualifications of its network support staff and thus in its ability to use them efficiently and train them.

25.107 The Department should review its network management policies and practices and make them consistent with a technology that may need updating every 36 to 48 months. It should reinforce its efforts to establish standards centrally and distribute them quickly.

25.108 The Department should ensure that network support personnel are adequately trained to perform their duties.

Department's response: *The recommendations at paragraphs 25.107 and 25.108 are accepted and the identification of practical solutions is*

The Department has decided to close this data centre, saving $21 million over five years (see paragraph 25.99).



being investigated in conjunction with acquisition, training and management activities for networks.

The assessments in the Operations Management area, which appear to be derived largely from the user survey, are accepted. They reflect the limited progress to date in overall systems integration, as well as the fact that training delivery has not been able to keep pace with the acquisition of work stations.

Software maintenance management is adequate

25.109 We reviewed the management of the Department's investment in software for four major systems: the Financial Information System, the Military Personnel Information System, the Canadian Forces Supply System and the Central Computational Pay System. These systems account for 40 percent of the Department's expenditure on software support.

25.110 We found that, in general, the Department uses modern techniques and tools to update and improve its software to meet user needs. The Department could improve them even more by doing better cost–benefit analyses of proposed system changes to maximize the benefit it receives from its programmers, and by improving the training that programmers receive.

Summary and Conclusions

25.111 Our audit indicates that there are fundamental problems in the way the Department of National Defence has managed information technology. There has been no central manager, accountable for information technology overall. The Department's system of program management appears to be unsuited to a technology that advances rapidly. Senior management does not have reliable information about the way project managers plan to spend their money or the funds that are actually available to meet requirements. Key priorities — such as the need to reduce operating costs and to meet military command and control requirements — have not been adequately addressed by the information technology program.

25.112 We also found that long–standing problems in project management still exist. The definition of requirements and the analysis of options remain inadequate and continue to result in extra costs to the Department.

25.113 Finally, we found that the Department has begun to address inefficiency in its telecommunications and computer operations. Significant savings have already been made, but implementing the bulk of possible savings is still in the planning phase.

25.114 The Department has already begun to focus on these problems. The new Defence Information Services Organization can provide a management centre to begin correcting problems in program and project management, and impetus to continued gains in operational efficiency. In addition, initiatives described in the previous chapter to implement business planning and "Defence 2000" in the Department are expected to result in more responsive management and a more efficient management process.

Chapter 26

National Defence

Infrastructure Reductions

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National Defence

Infrastructure Reductions

Assistant Auditor General: David Rattray
Responsible Auditor: Peter Kasurak

Main Points

26.1 The Department of National Defence operates 30 Canadian Forces bases, several exercise and training areas, and numerous radar stations and other smaller fixed installations in every part of Canada. It spends about $750 million annually to operate and maintain these sites, on which it has approximately 34,000 buildings.

26.2 The Department has carried out three major studies of its portfolio of infrastructure holdings since 1975, but has not adequately linked its portfolio to the requirements created by its force structure. Overall, the portfolio is neither linked to the needs of war and emergency nor configured to minimize costs.

26.3 Decisions intended to reduce Defence infrastructure holdings have been delayed because of government concern about the impact of base closures on local economies as well as the potential political impact. Our study of the closure of two bases — Base Summerside and Base Portage La Prairie — indicates that the government saved a substantial amount of money, when all costs are considered. To date, the local economies have suffered few ill effects. However, the absence of a coherent government framework for carrying out the closures and of a clear strategy for mitigating negative economic impacts led to enormous resistance in the communities concerned.

26.4 The use of the federal budgetary process, with its attendant secrecy, provides no opportunity to prepare the labour force and communities for change, and to plan a strategy for government assistance. After the 1989 Budget announcement of closures, emergency financial assistance was provided to affected communities; not all announced closures and reductions actually took place.

26.5 An open process, as used in the United States and as recommended by the Minister's Advisory Group on Defence Infrastructure, would permit open, rational planning. Although officials pointed out that such a process is time–consuming, major restructuring of Defence bases is required only infrequently.

26.6 We compared current holdings with those of the Australian Defence Force and with alternatives considered by the Department during its own studies. Both comparisons indicate that there will be room for further base reductions after the 1994 Budget cuts have been implemented.

Background

26.7 National Defence has a budget of $11.5 billion to deliver its Defence Services Program during fiscal year 1994–95. The bulk of the budgeted departmental activity takes place at 30 military bases and other related facilities. How the Department configures this infrastructure can have a great impact both on local economies and on the cost–effectiveness of Defence services.

26.8 Establishing the appropriate number of Defence bases and installations has been a long–standing problem. After dramatic growth during World War II, the Department made frequent reductions in its holdings. By the 1970s it was clear that there was a need to rationalize Defence facilities, and in 1976 the federal government developed a blueprint for Defence infrastructure.

26.9 However, the government did not proceed with the plan. Because Defence facilities tended to be located in regions with slow economic growth, the government decided that the Department could close a base only if "replacement" activities for the base could be identified. As a result, only two facilities were closed — Canadian Forces Ammunition Depot Renous in New Brunswick in 1978 and Canadian Forces Station Churchill in Manitoba in 1980.

26.10 The high cost of maintaining unneeded facilities did lead to some closures throughout the 1980s. Between 1986 and 1990, there were 21 Pinetree Line radar stations closed, causing relatively little controversy because the installations were small and, in many cases, remote. A second and more significant round of closures and reductions was announced in the 1989 Budget: the government announced its intention to close eight sites and to reduce six others.

National politics have affected rationalization

26.11 Not all infrastructure reductions announced in the 1989 Budget have been carried out: the Minister reversed the decision to reduce Canadian Forces Base Winnipeg, and the decision to close Canadian Forces Base Moncton has not yet been carried out. The communities of Summerside and Portage La Prairie reacted strongly to the 1989 announcement of their base closures, gaining national attention and extensive financial assistance from governments before the bases were closed.

26.12 The reduced global military threat and increasing pressures on government budgets have changed the political climate for the Department. The 1994 Budget announced the closure of four bases and the reduction of several other sites; most of the announced reductions had been recommended by the Department.

26.13 The Defence Policy Review now under way may result in significant changes in the Canadian defence force. Reductions in the size of the armed forces would reduce the need for infrastructure. In addition, declining budgets have put increasing pressure on the Department to reduce overhead costs. These factors make it important to ensure that Defence infrastructure is the "right size" and that appropriate plans and procedures are in effect to achieve that goal.

Previous Audits

26.14 In previous years, we did not audit specifically the Department's efforts to rationalize its infrastructure. Still, our 1990 audit of human resource

National Defence operates 30 Canadian Forces bases in every part of Canada (see paragraph 26.7).



Aerial view of CFB Petawawa, Ont.

Ships and Dockyard CFB Esquimalt, B.C.





Aerial view of CFB Cold Lake, Alta.

management found that the need for military colleges could be accommodated with two colleges rather than three, and that medical facilities were significantly underused. In our 1992 follow–up we noted that the Department had completed some minor rationalization of medical facilities.

Audit Scope and Approach

26.15 To support defence activities properly, the Department needs the right amount and type of infrastructure at the right location. National Defence must match its infrastructure holdings with the force structure requirements that it projects over a 15–year planning period. Departmental managers must achieve this at the lowest possible cost from the starting point of the Department's current holdings.

26.16 We assessed whether National Defence holds the appropriate infrastructure to support its operations in peace and in times of emergency.

26.17 To form an opinion on the justification and rationalization of National Defence infrastructure, we examined the Department's related plans. We reviewed major studies the Department had undertaken to define its minimum infrastructure requirement. We compared Canadian rationalization practices to those of the United States and analyzed two base closures in Canada. We also conducted a limited comparison of some Canadian infrastructure holdings with those of similar operational units in the Australian Defence Force.

26.18 The cut–off date for our findings was 30 April 1994.

Audit Observations and Recommendations

Force Structure Requirements Must Be the Basis for Property Holdings

26.19 The 1994 Budget announced the reduction of five bases, the consolidation of two bases, and the closure of four bases, two detachments, two military colleges and several other minor sites. National Defence officials informed us that the process of identifying closures and reductions began in the fall of 1993 with a defined dollar–saving objective. At the same time, the Chief of the Defence Staff issued instructions to achieve the "minimum required infrastructure". An Infrastructure Review Board was set up and made recommendations to the Minister, with estimated savings. After consultations among departmental officials, the Minister, Cabinet, and members of Parliament on the Government side, the government significantly altered the package of recommendations and identified additional reductions in Defence infrastructure.

Despite action to streamline excess infrastructure, the portfolio still is not based on long–term needs.

26.20 Since 1975 the Department has carried out three major studies — in 1975, 1988 and 1993 — that attempted to define the minimum infrastructure requirement for the Canadian Forces. Their conclusions showed much similarity, but also varied in some important respects.

26.21 The 1975 study was the only one that started from first principles, assessing the minimum infrastructure needed to support the Canadian Forces. Although the minimum requirement it identified was 12 bases, it recommended reducing what was then a total of 32 bases to 23. The Department provided Cabinet with its

recommendations, but no significant action was taken.

26.22 The 1988 study was based on the 1975 study recommendations. The 1988 study had some impact on the closure and reduction announcements in the 1989 Budget, but its recommendations were altered substantially by a departmental review and also at the ministerial level.

26.23 In 1993, a representative committee of senior officers, called the Infrastructure Review Board, determined the rationalization proposals that would achieve the targeted savings and reduce infrastructure to the minimum required. It was supported by computer modelling, as well as by costing and manpower analysis. Its recommendations formed the basis for the 1994 Budget announcements.

The 15–year Defence Development Plan does not deal with how the existing infrastructure should be managed and rationalized during the 15–year period.

26.24 The force development process in National Defence is the basis for determining its long–term infrastructure requirements. National Defence began to address the infrastructure component of strategic force development with the production of the Force Development Plan in 1992 and its successor, the Defence Development Plan, in 1993. The force development process focusses on incremental changes to infrastructure requirements, but has not yet made a baseline link with the people, equipment and operations in the strategic plan. To meet its reduction targets, the Infrastructure Review Board changed many of the projections in the Defence Development Plan.

26.25 We examined the planning process and existing plans to assess their impact on infrastructure rationalization. We found that planning for strategic force development and mobilization appears to be poorly linked with facility development plans, which map out the infrastructure needed on each base. The Department lacks strategies for effectively managing and rationalizing the existing infrastructure in concert with long–term construction programming.

26.26 The Defence Development Plan makes reference to construction programming for each of the commands over the next 15 years. However, it focusses on incremental changes and does not sufficiently address a number of key areas, namely:

- the resources needed to finance acquisitions of equipment and facilities;
- the impact of equipment and facility acquisitions and staffing adjustments on the existing infrastructure;
- how the existing infrastructure should be managed and rationalized during the 15–year planning period;
- the impact of war and possible other emergencies on infrastructure requirements;
- guiding principles for infrastructure to support the Reserves; and
- the linkage between the Defence Development Plan and existing facility development plans.

26.27 In our review of facility development plans we found that:

- proposed courses of action do not appear to be supported by a well–defined decision support system that examines life–cycle economics and costs and ensures that building construction and operations and maintenance costs are minimized;
- the plans do not address what should be done with the existing infrastructure;
- the Master Facilities Development Plan states that it is based on current approved policy, role missions and taskings. However, the base facility development plans produced between 1987 and 1990 did not make reference to

the 1988 Canadian Forces Development Plan, Infrastructure Planning Guidelines, a program control board master plan or other departmental strategic planning documents; and

- the plans generally were not reviewed every five years as departmental policy requires.

26.28 National Defence recognizes that it must conduct a complete review of planning for mobilization and force readiness to conform with the government's anticipated new defence policy. Work in that area is progressing, along with work on the policy, but no revised mobilization and readiness plans have been approved to date. Commands have not yet fully defined their infrastructure requirements for their end–state force structure or for further augmentation needed in the case of mobilization or other contingencies.

Decisions have been delayed by considerations of social and economic impact

26.29 Our examination of National Defence studies and action taken subsequent to them found that, at least until the 1994 Budget, government concern about the impact of base closures on local economies and the potential political fallout led to indecision. No established government framework existed for dealing with the issue of local economic impacts of base closures, although several departments and agencies had a jurisdictional interest. National Defence, however, continued to bear the cost of keeping bases open even as budgetary pressures increased.

26.30 To gain an appreciation of the impact of base closures on local economies, we conducted our own study of two base closures. During the course of our study we also reviewed similar experience in the United States. We considered the 1992 report of the Minister's Advisory Group on Defence Infrastructure and reviewed existing National Defence information on economic impacts. Our study focussed on the two major base closures carried out as a result of the 1989 Budget announcement: Canadian Forces Base Summerside and Canadian Forces Base Portage La Prairie. We asked, "Are the two communities significantly worse off since the closure announcement, and has the government really saved money?"

26.31 Using Statistics Canada census data from both before and since the closure announcement, as well as personnel, financial and housing data from National Defence and other government sources, we tracked the progress of government financial assistance negotiated after the announcement and the subsequent condition of the two local economies.

Government financial help reduced the negative local economic impacts of closing bases in Summerside and Portage La Prairie.

26.32 The main findings of our study are as follows:

- The information on economic impacts of military bases that National Defence compiled to support the 1989 decision was founded on provincial and national demographic and economic indicators. As local conditions can vary substantially, those indicators were not appropriate for making decisions on closures.

- Decision makers relied on National Defence estimates of savings that were not rigorously derived and that contained many flaws. Savings figures presented did not allow for any financial assistance to communities, and underestimated closure costs. For example, after accounting for National Defence internal audit revisions to expected savings, and allowing for the cost of federal financial help to the community, we estimated savings at Portage La Prairie to be

Government financial help allowed closed bases to continue to play an important economic role in the communities studied (see paragraph 26.32).



Aerial view of the former CFB Portage La Prairie, Man.



Aerial view of the former CFB Summerside, P.E.I.

$170 million (in Budget–year dollars) over the 15–year departmental planning period, compared to the $411 million originally estimated by the Department for the same period.

- The absence of a coherent government framework for carrying out the closures and of a clear strategy for mitigating negative economic impacts contributed to enormous resistance in the communities. Subsequent financial assistance, negotiated in reaction to the backlash, turned out to be extensive.

- Even though the nature of government financial assistance was largely unplanned, available evidence indicates that it mitigated the negative impacts of base closures on the local economies of Summerside and Portage La Prairie. In both cases, the local economies have shown few ill effects from the closures.

- Despite the extent of its financial assistance, the federal government began achieving net savings fairly soon after the closures.

26.33 In the case of Summerside, we estimate that net savings (in Budget–year dollars) over the 15–year National Defence planning period after the closure will reach $850 million (Exhibit 26.1). We estimate savings to the end of 1993–94 at $132 million, with the federal treasury having broken even in 1991. In the case of Portage La Prairie, we estimate that net savings over the same 15–year period after the closure will reach $170 million (Exhibit 26.2). We estimate savings to the end of 1993–94 at $8 million, with the federal treasury having broken even in 1994.

There are many cost and social advantages in the approach to United States base closures

26.34 The United States has had considerable experience in closing military bases. In the past, regional political pressures had made it very difficult to close bases in that country. To deal with the problem in the fairest way possible while maintaining a minimum of infrastructure, Congress passed legislation that sets out a framework for a workable solution.

26.35 The United States legislation has streamlined the political process and virtually eliminated political bartering, by requiring the armed services to downsize their infrastructure holdings to match reductions in their force structure; by

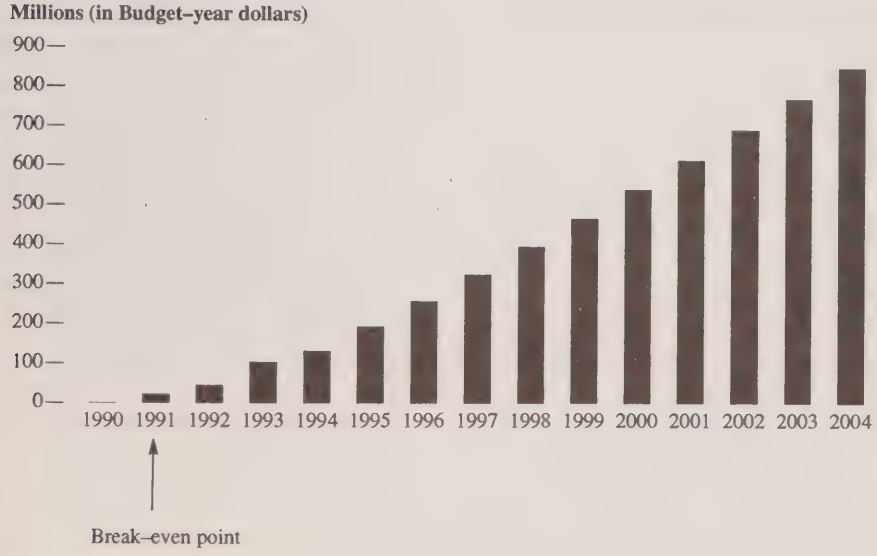


Exhibit 26.1

Federal Government Breaks Even Soon After Base Closures

Estimated Net Cumulative Savings End of Fiscal Year

Summerside

setting up a Base Closures Commission that holds public hearings on the proposals from the military and proposes a package to Congress; and by requiring the legislative and executive branches to approve the recommendations for closure as a package, within a limited time.

26.36 In the United States, the armed services are forced to explain their proposals publicly against clear criteria that include military necessity and extent of potential savings. Communities affected have a forum to air their concerns, and they generally perceive the process as fair. The process also provides communities with time to organize early, reducing backlash and demands for financial assistance. In addition, the government has made clear from the outset that financial assistance will be limited to helping communities organize, and has set up a mechanism to provide that assistance.

26.37 In its 1992 report, the Minister's Advisory Group on Defence Infrastructure endorsed the principles of clear criteria for closures and an open process under an independent panel. It recommended that an interdepartmental committee be set up to handle government financial assistance. The House of Commons Standing Committee on National Defence and Veterans Affairs endorsed the report. The Minister at the time deferred action. Departmental officials told us they estimate that, under this recommended process, it would be two years before a closure could be announced; the length of the process is a particular concern.

26.38 The current government's intent was to move quickly on its closure decisions, and it chose the Budget as the vehicle to announce them, as was done in 1989. It has essentially rejected the main components of the U.S. approach, namely a legislative requirement that the amount of infrastructure match the size of the force structure, retention of infrastructure according to well–defined military priorities and requirements, open public debate on closure proposals and a well–defined process for providing government financial assistance.

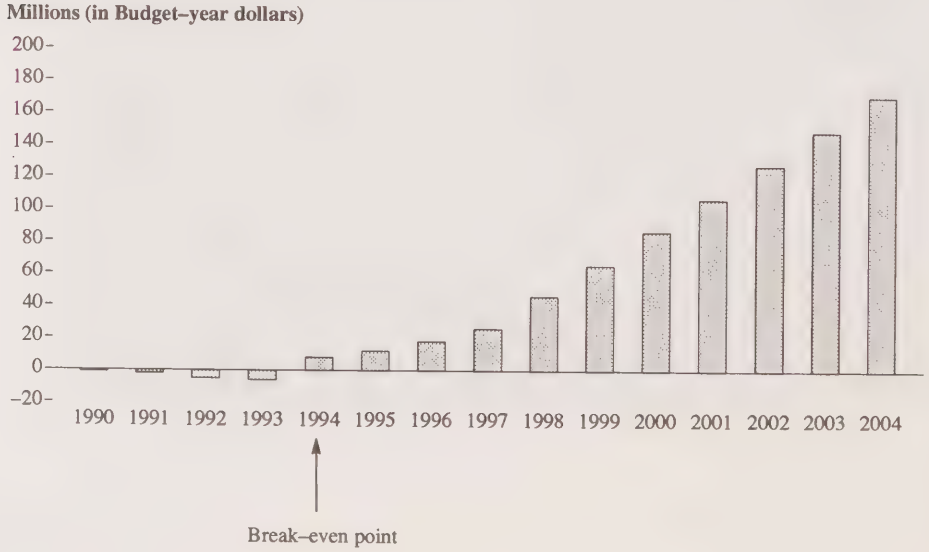
26.39 Although quick action may have been justified, and it provided the Department with a way to meet planned budget cuts, we note that the budgetary process provides no opportunity to prepare the labour force or the communities for

Exhibit 26.2

Federal Government Breaks Even Soon After Base Closures

Estimated Net Cumulative Savings End of Fiscal Year

Portage La Prairie



change, and to plan a strategy for government assistance.

26.40 Following the 1989 Budget announcement, emergency financial help was needed where bases were closed. Moreover, not all the announced closures and reductions took place. For example, the decision to reduce Canadian Forces Base Winnipeg was reversed and the closure of Canadian Forces Base Moncton has not yet been carried out. We also note that, since the 1994 Budget, financial assistance in one case has already been promised through the expected transfer of infrastructure and property to a province for one dollar. In addition, the debate on the closure announcements is occupying the attention of Parliament instead of being conducted before an independent panel. It is not clear that closures by the chosen process will take place more quickly than by the process recommended by the Minister's Advisory Group.

26.41 We believe that the model proposed by the Minister's Advisory Group on Defence Infrastructure, similar to the U.S. model, offers important benefits. It ensures that infrastructure holdings are aligned with measurable force structure components; it enhances objectivity in decision making by basing decisions on well–understood criteria and rigorous financial and economic information; it co-ordinates government and community efforts in preparing for the changeover; and it develops a plan and budget for government financial help. Although an open process such as the one suggested could take over two years to produce a decision, it would have to be done only once every several years and would likely arrive at an economically sound solution consistent with long–term force planning.

There is opportunity for further rationalization and long–term savings

26.42 To understand the total infrastructure requirement, we compared property held by the Canadian Forces with Australia's holdings for a mechanized army brigade and an air force squadron. Both are similar to their Canadian counterparts in size, role and equipment. We also used the Department's computer model for infrastructure to assess potential savings from consolidating operating units on fewer bases.

26.43 Our comparison of Canadian and Australian holdings revealed that the amount of infrastructure for operating units is similar in both countries. At the same time, it underlined the impact on infrastructure holdings of alternative methods for providing support services. Support services use a large portion of Canadian base infrastructure. In Australia, support services are not always provided directly by the defence department.

26.44 Although we were not able to compare the full cost of these alternative methods of providing support services because the information is not available, our comparison points to the importance of reviewing such methods in the process of base rationalization. We found that holdings are similar in most respects, with one important exception. Australia's concept of base support relies on a separate entity to operate its married quarters, on municipal services for its utilities, and on contractors for its engineering and maintenance services. So those support services require few personnel and a minimum of infrastructure held by the Australian Defence Force. As the Canadian Forces continue their efforts to reduce the number of bases, they need to investigate the costs and benefits of this alternative method of providing support.

Using the federal Budget process to close bases provides no opportunity to prepare the labour force or the communities for change, and to plan a strategy for government assistance.

It requires considerably lower capital investment in infrastructure and may prove to be more economical in at least some locations. (Exhibit 26.3)

26.45 The Australian air squadron is situated in a desert with no large municipality adjacent and it needs considerable storage space for supplies. It also has extensive fortifications to support its particular role. Our comparison with the Canadian squadron showed that holdings are similar once those factors are taken into account.

26.46 We also tested the Department's computer model for infrastructure, referred to by the Minister's Advisory Group on Defence Infrastructure. We found that the computer model can be a useful simulation tool, but it requires more development to become dependable on its own. National Defence is aware of the model's limitations, and used a combination of computer modelling and military judgment to support the 1993 Infrastructure Review Board activities.

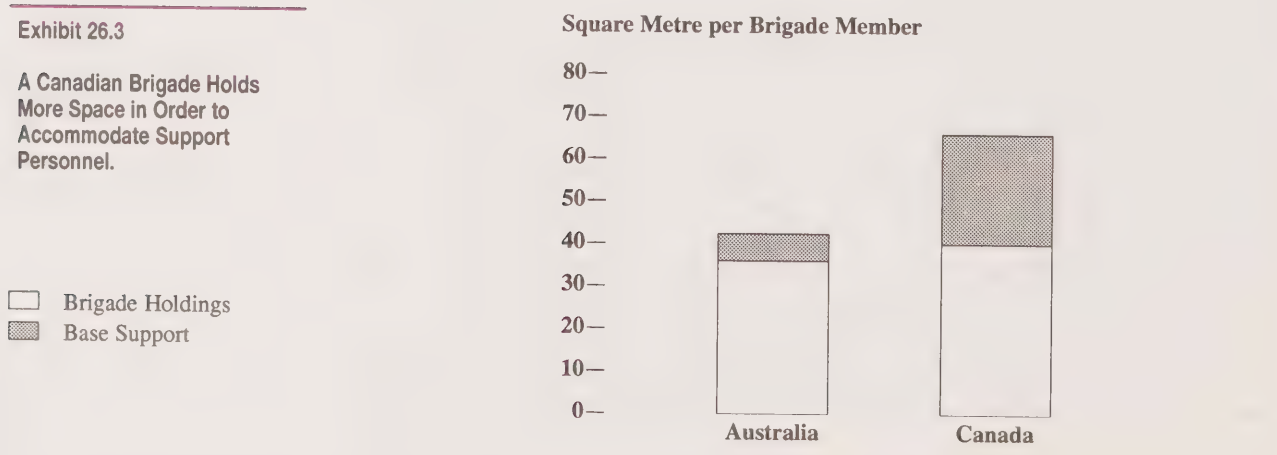
26.47 We used the model with the assistance of Defence military personnel to assess the military and financial impacts of reducing infrastructure to the minimum requirement of 12 bases, as justified in the 1975 study. The modelling showed that military capability would be enhanced. As well, depending on the chosen configuration, savings of between $360 million and $970 million per year could result, chiefly by consolidating support staff. To achieve those savings, approximately $1.3 billion to $2.5 billion in new infrastructure would have to be built, assuming a cost of $2,000 per square metre. However, departmental officials cautioned that, in their opinion, the 1975 approach is obsolete in the context of current needs. Nevertheless, they agreed that there will be room for further rationalization once the reductions called for in the 1994 Budget have been implemented successfully.

26.48 Both the comparison with Australia and the computer modelling indicate how support staff levels impact on infrastructure requirements. By the same token, keeping infrastructure holdings at a minimum reduces the need for maintenance, and may lower operating costs.

26.49 Based on its long–term force development plans, the Department should advance its development of a

Exhibit 26.3

A Canadian Brigade Holds More Space in Order to Accommodate Support Personnel.



* Canadian and Australian Forces rely on different concepts of base support (see paragraphs 27.43 and 27.44)

comprehensive, fully integrated strategy for portfolio management and investment to define: the optimum infrastructure for the Total Force; requirements for new infrastructure, replacements and disposals; and maintenance strategies.

Department's response: *The Defence Development Plan (1993) continues to be the strategic plan that defines force structure and the required resources, including infrastructure, to support such a force. As recognized within this chapter, the optimization of departmental infrastructure, beyond the rationalization that is being performed, is a monumental undertaking involving hundreds of millions of dollars. Consequently, the Department will defer additional detailed facilities assessments pending further refinement of the Development Plan following currently planned reductions and the ongoing defence policy review.*

26.50 Where base closures or reductions are required, the government should consider an independent process, open to public scrutiny and involving all parties. Cost–benefit studies of proposed financial assistance to affected communities should be conducted.

Overall Conclusion

26.51 Our audit found that, overall, National Defence has experienced difficulty in tailoring its portfolio of infrastructure to its military requirements. Government and departmental managers need to bring infrastructure holdings into line with the minimum requirements of the planned force structure. They need to provide the right numbers and types of properly maintained buildings and properties in the right places to support key defence activities effectively, for both peacetime and emergency requirements. Limited Canadian experience and the experience of other countries indicate that savings can be made while respecting political realities.

Chapter 27

National Defence

Infrastructure Management

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National Defence

Infrastructure Management

Assistant Auditor General: David Rattray
Responsible Auditor: Peter Kasurak

Main Points

27.1 The Department of National Defence administers the largest portfolio of property in the country. Its capital construction budget is around $270 million, the largest in government. It employs 2,000 military and 6,900 civilian person–years to manage its infrastructure and spends over $750 million annually on personnel, operations and maintenance. Of the 34,000 buildings in its portfolio, roughly 24,000 are married quarters.

27.2 Management of infrastructure acquisition needs to be improved. As we pointed out in previous audits, the processes for capital acquisition are cumbersome. Poor definition of requirements, design inconsistencies and a nine–year average completion time for projects resulted in excess costs to the Department, and projected savings from projects were not realized. Some major replacement construction projects were not supported by approved long–term force development plans.

27.3 National Defence has complied with government directives and set up an environmental program. However, the clean–up portion of the program will not be accomplished within the original objective of 10 years and may take as many as 20 years. Estimated costs are higher than planned resources. Accountability for achieving the objectives is diffused. The $700 million estimated cost for clean–up is significant, but has not been consolidated and reported fully to Parliament.

27.4 Unsatisfactory accountability contributes to inefficiency and high costs in infrastructure management. National Defence has been slow to correct known problems, such as delays in the approval of capital replacement projects and losses on permanent married quarters. Information systems are antiquated, poorly linked and provide little costing data. Known cost–saving initiatives developed in one location are not implemented across the Department.

27.5 The Department needs to make fundamental improvements in its management of infrastructure to match commercial quality. We estimate a potential for operational savings of over $100 million per year. National Defence's objectives for holding and managing permanent married quarters are unclear, and costs are excessive. The productivity of in–house maintenance trades is significantly lower than in the private sector. Infrastructure is ageing and approximately $1.7 billion of maintenance has been deferred. Operating funds are being used to refurbish existing buildings or replace works because the process for construction approvals is excessively cumbersome.

27.6 National Defence recognizes that change is necessary to reduce costs. It is attempting to introduce business planning to improve accountability, is proposing a special operating agency to manage its permanent married quarters and is conducting trials of new management techniques. There is no formal government support for exposing internal operations to competition, and certain provisions of the government's Work Force Adjustment policy work against such an approach. National Defence's efforts to make its internal operations competitive with the private sector are lagging behind those of defence departments in certain other countries where legislative support exists. Where it has taken initiatives, it has been successful in streamlining operations or achieving savings.

Background

National Defence holdings are extensive

27.7 National Defence administers the largest portfolio of property in the country: its land holdings rank second in area only to those of the Canadian Heritage department's national parks. Its capital construction budget is around $270 million, the largest in government.

27.8 The departmental organization responsible for infrastructure is Construction Engineering, a function that involves 2,000 military and 6,900 civilian person–years. This function alone is larger than some government departments. In addition, it contracts out major portions of its work.

27.9 National Defence estimates the cost of replacing all its buildings and works at more than $17 billion. It has not estimated market values and assigns no value to land. Of the 34,000 buildings it manages, roughly 24,000 are married quarters.

27.10 Construction Engineering spends over $750 million annually on personnel, operations and maintenance. In addition, Public Works and Government Services Canada annually remits approximately $110 million in grants in lieu of taxes for National Defence properties.

27.11 Over the last several years, National Defence has successfully conducted trials of new methods of managing its bases and infrastructure support. National Defence senior management is now attempting to change the management culture and move toward better accountability through "business planning", which involves decentralizing of authority and costing of activities.

27.12 The current government has announced a defence policy review, expected to have an impact on roles for the military and on force structure.

Previous Audits

27.13 Our 1984 government–wide audit of real property found that departments did not comply with policies on the management of real property. Some of the recommendations arising out of that audit applied to National Defence. For example, we recommended that potential savings or loss of revenue be considered in assessing the efficiency of actual and potential uses of real property.

27.14 Our 1984 audit of National Defence found shortcomings in the economic analysis of construction projects and in post–completion review.

27.15 Our 1992 audit of Canadian Forces Reserves found major deficiencies in the acquisition of Reserve facilities.

Audit Scope

27.16 Our audit addressed asset management, maintenance and operations and environmental management. We included all National Defence buildings, properties and works. We excluded leased office facilities. The cut–off date for our findings was 30 April 1994.

27.17 To support defence activities properly, the Department needs the right number and type of infrastructure at the right location. Each building has a life cycle of acquisition, maintenance and disposal. Life cycle management means getting the maximum use from the building at the lowest total cost for the whole life of the building. National Defence must match its infrastructure holdings throughout their life cycle with the force structure requirements projected

National Defence employs 2,000 military and 6,900 civilians to manage its infrastructure.

National Defence administers the largest portfolio of property in the country (see paragraph 27.7).

New Supply Building, CFB Bagotville, Que.





St. Luke Chapel, CFB Edmonton, Alta.

Aerial view of Maritime Command HQ, Halifax, N.S.





De Salaberry Armouries, Hull, Que.

Construction Engineering vehicle at CFB Ottawa (North), Ont.





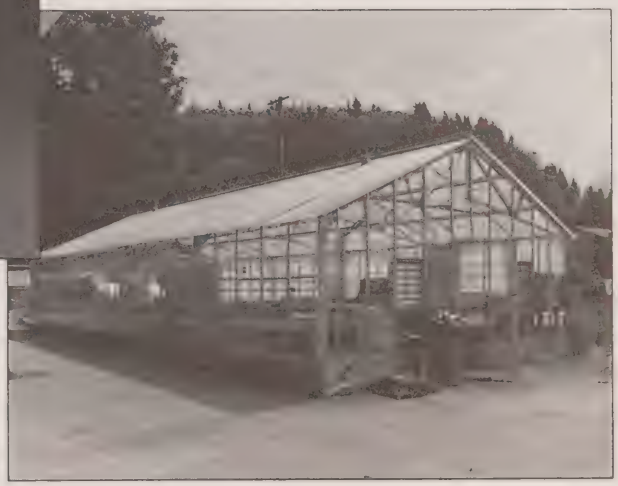
Jetty D, CFB Esquimalt, B.C.



Aerial view of North Warning System (Dew Line) site at Shingle Point, Yukon Territory



Heating Plant, CFB Ottawa (South), Ont.



Greenhouse at CFB Chilliwack, B.C.



Community Centre at CFB Chilliwack, B.C.

over a 15–year planning period. Departmental managers must do this at the lowest possible cost, from the starting point of the Department's current holdings. Our audit assessed the Department's practices at each stage in the management process.

27.18 In conjunction with the previous chapter on infrastructure reductions (see Chapter 26), we assessed whether National Defence holds the appropriate infrastructure to support its operations in peace as well as in times of emergency. We also assessed whether the portfolio is well managed, with due regard to economy and efficiency.

Managers must continually renew the portfolio and get the best use for the least cost from existing facilities.

Observations and Recommendations

27.19 In our 1984 chapter on real property we set out the five stages in the life cycle of facilities: needs definition, options analysis and requirements definition, acquisition, in–service management and disposal. Using the most appropriate techniques and information systems for life cycle portfolio management, managers must continually renew the portfolio and get the best use for the least cost from existing facilities until they are no longer suitable and are disposed of. They must do this within existing laws, regulations and departmental policies. The sections below follow this life cycle approach.

Construction Management Needs to Be Improved

Construction expenditure is significant

27.20 The Department spends about $200 million every year on major construction projects valued at between $1 million and $100 million each to replace existing infrastructure. In addition, it spends $70 million yearly on minor projects. We examined 15 of 93 major construction projects involving facilities that have been occupied since 1990 or that should be occupied by 1996. Most of those projects had been reviewed and approved by Treasury Board. We did not examine construction projects to support new military equipment.

High–priority construction projects were within budget and on time

27.21 The projects managed under a high–priority National Defence Headquarters initiative — the Infrastructure Adjustment Program — to accommodate the 1989 base closures and the closures in Europe did not encounter the problems we observed in projects managed through the normal process. They were accorded high political and departmental priority. These projects were generally completed on time — in approximately four years — and for around the original estimated cost. They experienced little staff turnover and used a streamlined approval process.

There are weaknesses in the management of the early phases of major construction projects

27.22 Our audit of major projects focussed on needs identification, project planning, design and implementation of the projects. We found important weaknesses in the management of the first three phases of major projects, especially in specifying the requirements to meet identified needs. In some cases, expected savings from the projects were not achieved as planned. As well, there were instances where the need for acquisition and construction was not substantiated by approved departmental long–term plans. The Defence Program Management System impedes timely replacement and

there is often significant turnover of project management staff.

27.23 We found instances where acquisition and construction has been carried out with the approval of force planning staff, although departmental long–term plans were in a state of flux. For example:

- In the fall of 1993 the Department contracted for the construction of a $5 million headquarters building at Canadian Forces Base Shearwater. Despite the fact that a study of possible base closures began in September 1993, the contract was awarded on 8 October 1993. The federal election took place on 25 October 1993. On 15 November 1993, departmental officials assessed the financial implications of stopping the project, and concluded that it was more economical to complete it. The 1994 Budget consolidated Base Shearwater with Canadian Forces Base Halifax, where there is also a new headquarters building under construction.

- A new armoury was built in St. Malo, Quebec at a time when the composition and role of the Militia were under fundamental review. There were no approved Militia establishments at the time and there were no official plans as to which Militia units would be kept under the Total Force restructuring. The Department chose not to opt for a temporary solution to the units' accommodation problems.

27.24 We found cases where there was a failure to clarify objectives and requirements during the planning phase of projects. For example:

- The Main Base Supply facility at Canadian Forces Base Halifax experienced many conceptual and design changes to the project. Unclear objectives and faulty analysis resulted in time and cost overruns. From 1982 when the project was registered in the Defence Services Program to 1993 when it was finally approved in its current form by Treasury Board, the project went through at least two major redefinitions. The 1988 statement of requirement was reworked in 1989 when senior engineering staff realized that it called for warehousing over 100,000 items that had not moved in four years. In 1991, after consultation with users, the 1989 design was discovered to exceed the space requirement by 16 percent, but officials decided there was not time for another redesign. The project is six years overdue, according to the original plan. There have been many advances in inventory management techniques since the requirement for this warehouse was first identified in the 1970s. Departmental officials told us that this was a particularly difficult project to define, which resulted in the delays.

- The new Peacekeeping Monument project did not properly define the requirement in its early stages. The final approved project cost ended up at 53 percent – or $800,000 – over the originally approved cost.

- The Fleet Maintenance Group facility at Canadian Forces Base Esquimalt was poorly planned. The information presented to senior management in support of the project turned out to be inaccurate. The actual cost was $13 million, or three times the original estimate, and the project was five years behind schedule. The Department has since strengthened its senior management challenge of individual projects.

27.25 In some cases, design decisions added costs and delayed projects. For example, in an attempt to reduce the cost of the Fleet Maintenance Group (Pacific) facility, National Defence Headquarters changed major building systems late in the design process, which led to subsequent problems. There was also poor co-ordination between sub–consultants. The impact of the problems was about



Main Base Supply facility at CFB Halifax is six years overdue (see paragraph 27.24).



Peacekeeping Monument cost $800,000 more than originally estimated (see paragraph 27.24).



Fleet Maintenance Group facility at CFB Esquimalt cost three times more than the original estimate and was five years behind schedule (see paragraph 27.24).

$350,000 in additional unforeseen environmental clean–up costs for the project. On the Main Base Supply facility in Halifax, designers added a specialized roof, justified on aesthetic grounds, that will cost an extra $685,000.

Delays are a significant concern

27.26 We found that Infrastructure Adjustment Program projects took close to four years to complete, while projects managed through the normal process required, on average, over nine years. The Infrastructure Adjustment Program completed projects in about the same length of time as required for similar projects in the private sector.

27.27 Departmental records show that projects valued at between $1 million and $10 million take just as long to develop as large projects. Projects over $10 million slip on average by about 30 percent, whereas projects under $10 million slip by about 130 percent. Planners appear consistently to underestimate the time required to undertake the smaller projects. Slippage can result in forgone operational benefits, turnover in project sponsor and management, higher costs and structures built for outdated needs.

27.28 The "pre–development phase" — or the time an approved requirement spends on a local priority list — averages almost eight years. During that period, projects are not tracked by the National Defence Headquarters project management system. National Defence Headquarters' program planning process does not include projects for facilities deemed essential to support the force structure or operations if they are not affordable; nor does it aggregate their estimated cost.

27.29 Officials told us that a lack of funding accounts for much of the delay, especially in the pre–development phase. In such circumstances, we expected to find a system that would give high priority to construction projects involving the highest savings as well as recognizing operational imperatives. The Department could then apply those savings to other construction, reducing the backlog and waiting time. However, similar to the situation described in our chapter on Defence Information Technology, no such strategy and system exist.

27.30 The Department should strengthen needs and requirements analyses for major replacement construction projects, and ensure that they remain current and consistent with force structure and base development plans.

Department's response: *Concur. Improved procedures have already replaced those existing during delivery of the audited projects. Statements of Requirements and pre–planning are more thorough than in the past and an enhanced Senior Review Board (SRB) process has been in place for the past year. The SRB ensures more focus on the concept of operations, the options analysis and the engineering solution that must satisfy minimum military requirements. The inclusion of a program analyst on the SRB will help address force structure issues. Refinement and strengthening of the process will continue.*

Regarding the Fleet Maintenance Group facility, it is acknowledged that initial planning was incomplete and that the final cost was more than three times the initial estimate due to mitigating circumstances. These circumstances included a change in the National Building Code related to all new seismic reinforcement criteria and unforeseen environmental clean–up costs incurred when the foundation design was changed in an attempt to reduce costs. The construction contract was not awarded until more than two years after full approval for the final $13 million

The departmental approval system for capital spending on replacement construction is lengthy and arduous.

amount was obtained, and the project was actually underexpended by $500,000.

27.31 The Department should take into account, in setting its priorities, the optimum savings to be achieved through construction projects, and should ensure that project planning, definition and implementation are performed in a timely manner.

Department's response: *It is agreed that savings must be factored into the prioritization of construction projects; however, operational need is the main determinant of funding priority. Infrastructure is managed to best support operations. In an effort to factor savings into the decision process, the 1994 Program Control Board Subcommittee conducted a business case analysis of each project to identify the consequence of deferrals on both operations and operating and maintenance costs. This process will be refined and employed as standard procedure. Additionally, the Defence Program Management system is being revitalized to ensure more timely delivery of construction projects (see departmental response 27.39).*

27.32 The Department should track its inventory of projects in the pre–development phase at National Defence Headquarters, using best estimates of costs and potential economic benefits. It should use that information in program and force development planning.

Department's response: *Concur. Projects in the pre–development phase are reviewed and resubmitted each year by bases and commands. With the initiation of project business cases in 1994, potential economic benefits of advanced project implementation will be updated and reconsidered annually. The impact of project deferrals will continue to be factored into project funding decisions (27.31). The Department is also developing a new initiative to quantify current and projected backlogs of infrastructure upkeep projects and their associated impacts to ensure that senior managers are provided with a full understanding of future infrastructure needs.*

Renovation practices contribute to deferral of maintenance

27.33 Acquisition, operations and maintenance, and renovation or "recapitalization" are spending phases in the asset life cycle. Capital spending occurs when the benefit of an expenditure is expected to be spread over coming years, either through acquisition or renovation.

27.34 Wise capital investments lower overall costs over the life of a building, and support efficient operations. However, property managers know that the timeliness of maintenance is also very important to achieving the lowest life cycle costs. According to private sector practice and a recent Treasury Board policy, substantial renovation that extends the useful life of a building or works is a capital investment. Proper life cycle management of buildings and works means striking the right balance at the right time between capital and maintenance spending.

27.35 According to National Defence policy, operating funds can be used to gut a facility completely, replace all major systems and rejuvenate it to last another 50 years, provided the planned use and dimensions of the foundation of the facility remain the same. That policy no longer conforms to Treasury Board policy, which defines such spending as capital spending. It also goes against generally accepted practices in the private sector. The Department spends approximately $70 million from its yearly maintenance budget on renovating buildings and works.

27.36 Departmental managers divert maintenance funds because the departmental approval system for capital spending on replacement construction is lengthy and arduous. It requires departmental committees to consider each capital project a minimum of three times; the Chief of the Defence Staff, the Deputy Minister and the Minister see the project twice; as well, Treasury Board twice reviews projects over $10 million. Rather than considering the option of building a modern facility, the approval system for capital funds leads managers to favour renovation of old facilities by turning to maintenance funds, which are more accessible.

27.37 A current example of how the Department uses maintenance funds for capital investment is its "rust–out" program to replace ageing utilities and works systems, such as heating and sewer systems on bases. The Department calculates that it needs $40 million to $60 million per year for ten years to replace major utilities and works. This represents roughly 20 to 25 percent of the maintenance budget that construction engineers will divert to renovation, under departmental policy and practices.

27.38 The diversion of maintenance funds to capital renovation contributes to the backlog of postponed required maintenance, addressed in the next section. It hinders managers from striking the right balance between capital and maintenance spending to get the best use out of buildings and works, at the lowest cost. It also distorts the financial information that is necessary to manage as well as to hold managers accountable.

27.39 The Department should revise its policies and practices for recapitalization to conform to Treasury Board policy on capital spending. It should streamline its process for approval of replacement infrastructure.

Department's response: *The Department of National Defence is working with Treasury Board officials to harmonize the definitions related to recapitalization and infrastructure upkeep. In September 1993, a departmental working group was established to streamline the approval process for replacement construction projects. Its recently concluded recommendations will be instrumental in effecting changes to expedite reviews and approvals.*

Management of Infrastructure Operations Can Be Improved

27.40 We found considerable evidence that the Department can improve management of infrastructure operations in the key areas of deferred maintenance, productivity of Construction Engineering, identification of potential savings by comparing its operations to those of other providers, and management of married quarters.

The Department calculates that it needs $40 million to $60 million per year for ten years to replace major utilities and works.

The Department has deferred maintenance of $1.7 billion

27.41 Maintenance is the upkeep of property, buildings and equipment: work that is necessary to realize the originally anticipated life of a fixed asset before disposal or major renovation. Maintenance does not prolong the original design or service life of an asset, nor does it increase its capacity. Deferring maintenance and repairs may lead to loss of performance or asset value or both, as well as to more expensive repairs later on if there is a continued need for the facility. Departmental officials told us that upkeep decisions are frequently based on crises or on availability of funds. The Department is at a stage where a large proportion of its buildings are old. As well, major works such as water, sewage, power and steam

Upkeep decisions are based on crises or on availability of funds.

lines and central heating plants require major refurbishment or replacement.

27.42 The Department has a system to measure how well it is maintaining infrastructure, but it has never estimated the cost of its entire amount of deferred maintenance. The Department's system relies on a variety of inspectors to point out necessary maintenance. There are over 220 maintenance inspectors at 30 bases in Canada, ranging from three at Base Comox to 18 at Base Halifax. The cost for these inspectors is approximately $12 million per year. Our visit to a major United States Air Force base revealed that it has only three inspectors. Due to cost considerations, it relies almost entirely on its base computer system and base maintenance personnel to signal potential problems. Our visit to the largest United States Navy base found only 12 inspectors, with no computerization. It also relies largely on tradespeople to flag problems. We did not attempt to compare the cost–effectiveness of these differing approaches. We note, however, that unless there is a good chance of obtaining funding for the necessary work, many of the Canadian inspectors' findings are never incorporated into any repair and maintenance schedule. This raises the question as to how much value the Department is getting from these inspections.

27.43 The Department attempts to fund its maintenance at 1.6 percent per year of plant replacement value. To ascertain the total amount of deferred maintenance, we selected a sample of 200 assets from approximately 20,000 individual items in the Department's system, with an estimated replacement value of $13.1 billion. We excluded infrastructure in Europe, vacant land, the North Warning System and community infrastructure such as housing, arenas and community centres. Departmental officials provided estimates of the deferred maintenance costs for each building or work in our sample, according to recent inspections. From those reports, we estimate that the Department's total deferred maintenance amounts to approximately $1.7 billion, or 13 percent of the plant replacement value. This represents almost a 10–year backlog of maintenance. The deferred maintenance for works is $900 million, and for buildings is $800 million.

27.44 The Department faces either a bow wave of unavoidable spending on replacement or accelerated deterioration and increased operating costs of life–expired buildings and works. The Department has not developed an overall strategy for dealing with its deferred maintenance.

27.45 The Department should introduce life cycle management for major individual elements of infrastructure to determine the most appropriate balances between capital and maintenance spending, monitor the amount of deferred maintenance of those individual elements as well as in total, and use the information in infrastructure planning.

Department's response: *Because of the unevenly distributed age of departmental infrastructure, the relative proportions of capital and maintenance spending will fluctuate over time. Therefore, the appropriate balance cannot be held constant. The Department has initiated an in–depth review to quantify current and projected backlogs of infrastructure upkeep projects and to identify the associated impacts. This process will broaden the life cycle knowledge base upon which infrastructure planning decisions are made.*

27.46 The Department should address its deferred maintenance at the same time as it rationalizes its infrastructure

to meet force structure needs. It should consider using savings from improved efficiency in operations to reduce the amount of deferred maintenance.

Department's response: *The issue of deferred maintenance will be addressed as part of the infrastructure backlog analysis currently under way (paragraph 27.45). The maintenance of infrastructure identified as redundant through the rationalization process will be reduced to minimum levels pending disposal. The Infrastructure Reduction Project (IRP), when complete, will reduce the amount of deferred maintenance outstanding in the long term, but the IRP savings will have already been placed in the defence envelope for redistribution.*

The productivity of Construction Engineering is low

27.47 The management of infrastructure is the responsibility of the Construction Engineering function in the Department. That organization includes almost 9,000 people. About 3,400 tradespeople are employed in the maintenance of buildings and facilities. The Department has defined jobs rigidly by trade specialty, even to the extent of having separate drivers provide transportation for trades workers. Construction Engineering costs the Department approximately $1 billion each year. Base tradespeople spend most of their time on trouble calls and small repairs. Overall, we found much room for improvement in the cost management of Construction Engineering human resources.

27.48 Low productivity is a long–standing problem. The Department has conducted a number of studies since 1980 that indicated problems with productivity:

- In 1980 an evaluation concluded that, while Construction Engineering was well–structured and managed, there was a perception of low productivity and efficiency. Comparisons with the private sector were difficult, however, because of differences in the type and age of assets.

- In 1985 the Department's Accommodation Working Group did a detailed study, at two bases over 14 months, of the cost of maintaining married quarters. The study compared the bases' trades operations with commercial sector practices. The results of the comparison are shown in Exhibit 27.1.

27.49 The 1985 study showed that the adoption of commercial practices could result in a 40 percent efficiency gain in the Department's use of maintenance personnel. The main opportunities for improvement centered around the projected use of handymen as opposed to trade specialists and the elimination of waiting time for transport by allowing tradespeople to drive themselves to the work site, instead of providing drivers.

A Defence study found that adopting commercial practices could result in a 40 percent efficiency gain in its use of maintenance personnel.

27.50 Using data from the study, we estimate that 134 person–years could have been saved in the maintenance of married quarters alone, by increasing the use of handymen and allowing tradespeople to transport themselves. The Department did not take significant action on the study. The study recommendation to remove control of the family housing from the military chain of command by forming a separate non–profit entity caused considerable concern in the Department. There was also concern over potential problems in staff relations if positions were changed or eliminated. The decision not to set up a separate non–public–funded housing authority aside, had National Defence found it possible to make greater use of handymen and personal transportation as suggested by the study, we estimate it would have saved over $41 million since 1985.

National Defence maintenance management improvement trials are saving $1.7 million per year.

27.51 In 1991–92, improvement trials at two Training System bases, undertaken with union co-operation, showed that $1.7 million a year was saved by improving Construction Engineering practices on the bases, such as reducing fire hall manning, providing vehicles instead of drivers to tradespeople, and changing the operation of heating plants. The provision of vehicles alone accounted for over $400,000 of that yearly saving.

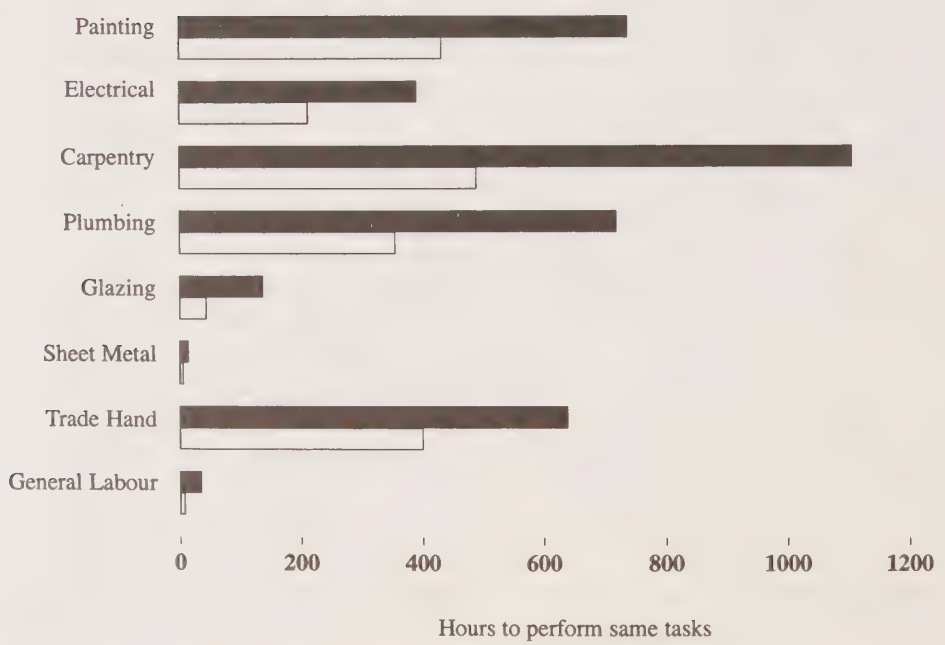
27.52 Air Command, also with union co-operation, has experimented since the early 1980s with an alternative method of managing Construction Engineering, which it calls "Socio–Tech". Like the Training System trials, it found that practices had been inefficient. On one base, the provision of vehicles to tradespeople freed up $528,000 in labour time over one year.

27.53 The Department's inability to take action has been costly. We conducted our own study of trades productivity to confirm the results of departmental studies and experiments. We compared the time reported on a sample of departmental work orders to perform maintenance tasks with the time estimates based on commercial standards and practices of two independent licensed quantity surveyors. Based on that comparison, the productivity of departmental tradespeople is approximately 33 percent below those in the private sector. We estimate that this costs the Department about $50 million each year. This finding is consistent with the previous studies and improvement trials conducted by the Department.

27.54 The Department has been aware of the low productivity of its Construction Engineering function for over a decade. More recent studies have provided additional evidence of the savings possible. National Defence is now at a

Exhibit 27.1

1985 DND Study Shows Private Sector Practices for Trades Are More Productive



crossroads and needs to take action on its own studies. It needs to adopt more flexible practices in human resource management and to use the resulting gains in efficiency to reduce the maintenance backlog, generate savings or some combination of the two. Under the 1994 Budget, the Department must reduce its civilian work force by approximately 8,400 people over the next four years. It has already introduced the Civilian Reduction Program, which will compensate workers who leave voluntarily. However, National Defence must attempt to implement the needed changes within the policy set out in the Treasury Board's Work Force Adjustment Directive and in the context of existing collective agreements. According to that Directive, National Defence shall guarantee to every employee whose position is no longer required, and who is retrainable and willing to move, a reasonable job offer in the public service. The Department must make a reasonable job offer within 16 kilometres of their current workplace to employees who are displaced due to contracting out. Given the isolated locations of many defence establishments, the Department faces a considerable challenge in making needed changes within the Work Force Adjustment policy, although the Civilian Reduction Program will help to alleviate the problem. Collective agreements require existing employees to work only in their trade speciality, but there is room to introduce handyman positions as collective agreements are renegotiated and as attrition occurs.

There are no systems or procedures in place to measure productivity

27.55 The Construction Engineering Management Information System cannot record costs for smaller routine repairs and compare actual costs to original estimates. Although an evaluation of Construction Engineering as far back as 1980 noted the lack of a system to measure productivity or efficiency, there are still no such system and procedures in place. The Department intends to test a new system next year and is also permitting four bases to purchase off–the–shelf software and to install their own systems.

27.56 For the ongoing operation and maintenance of its infrastructure, the Department should:

- **have better information for day–to–day decision making on infrastructure maintenance, including some form of evaluation of labour productivity;**
- **develop a national strategy for dealing with its human resources that will allow it to introduce changes quickly to address identified inefficiencies; and**
- **gain union co-operation to introduce across the system the "best practices" from successful improvement trials.**

Department's response: *Concur. The new management information system, which is currently being implemented, has the capacity to support more informed decision making. Additionally, the incorporation of more businesslike practices in daily decision making will have a positive effect on labour productivity.*

The Department needs to compare itself with other service providers

27.57 Defence departments throughout the world tend to have developed as vertically integrated organizations. That is, they have performed all the functions needed to operate, including most support functions. Over the last 10 years, the need for this has been questioned in the United Kingdom and the United States. Those

Inviting competition from the private sector has saved money in other countries, but current Treasury Board agreements impede such an approach.

countries have legislated programs that require government departments to submit support functions to competition from the private sector to ascertain if the function can be provided at lower cost, either in–house or by contracting out. There is no similar legislation or central agency direction in Canada.

27.58 National Defence conducted some studies on contracting out as part of its Defence 2000 initiative, but it does not have a definite program to make internal functions compete with outside providers. The Treasury Board Work Force Adjustment policy and collective agreements with civilian employees referred to previously, although they do not expressly forbid such an approach, tend to impede it.

27.59 We studied the progress of the United States and the United Kingdom in putting internal functions to competition and found that both countries have achieved significant savings. Savings in all the base support functions, including infrastructure, totalled U.S.$613 million for the U.S. Department of Defense over the period from 1979 to 1986. Of this amount, U.S.$89 million was saved on maintenance of facilities, grounds and utilities and a further U.S.$156 million on multiple activities, which could include infrastructure maintenance.

27.60 In the United Kingdom, the Ministry of Defence estimated that exposing functions to competition yielded average savings of 24 percent and, currently, over £60 million per year. In the United States, U.S.$128 million or 20 percent of the savings identified were achieved by improving the 50 percent of functions chosen to be kept in–house. The experiences of National Defence and those of other countries indicate that comparing internal infrastructure support operations to those available from other service providers can lead to streamlined operations as well as savings.

27.61 National Defence has not systematically examined infrastructure maintenance functions to determine how advantageous it would be to expose them to competition from external providers. Defence officials consider that such an approach would be made extremely difficult by the Treasury Board's Work Force Adjustment policy, which, as noted previously, guarantees a reasonable job offer in the same vicinity to civilian employees displaced by contracting out. However, National Defence has completed several significant initiatives, for example:

- Contracting out primary flight training from 1992 until 1997 resulted in a transfer of the base at Portage La Prairie to a non–profit organization. By streamlining its requirements for base support and handing it over to the private sector, National Defence estimates that it has saved $19 million to date and will save an estimated $73 million over five years.

- A trial at the training bases compared base transport and housing management to services of other providers, resulting in streamlined procedures and savings of $10 million since 1991.

Putting the entire Construction Engineering function to competition can yield savings

27.62 Recent base closures have allowed civilian contractors to manage base Construction Engineering services. We considered the impact of contracting out at Canadian Forces Base London and the former Canadian Forces Base Portage La Prairie. At Canadian Forces Base London, most Construction Engineering functions had already been contracted out

before the base was closed, and no additional savings were identified.

27.63 At Portage La Prairie, the Department had employed 105 person–years and required a budget of $5.25 million in 1990–91. A private sector firm employing 32 staff now holds contracts to operate and maintain the base infrastructure.

27.64 The overall cost of operating and maintaining the former base infrastructure is now about $3.7 million per year. We were informed that this amount includes costs for dealing with a backlog of deferred maintenance and that operating and maintenance costs are expected to reduce over time. However, the contractor has no military operational role and is not responsible for maintaining the married quarters, as they are being rented out. The contractor can meet the Forces' streamlined requirements for a five–day week, one–shift operation with the present level of staff. The Department is considering a similar approach to maintenance management at its Meaford site.

27.65 National Defence should compare its Construction Engineering function at each base with other service providers.

Department's response: *Concur. In addition to other facilities with a replacement cost in excess of $6 billion, the Department manages about 11.5 million square metres of housing and general and special–purpose building infrastructure. To provide perspective, the five largest commercial real estate developers in the country manage a combined total of about 11.6 million square metres — largely office towers. No private or public organization approaches the scope and scale of the Department's infrastructure management responsibilities. The primacy of operations also adds a unique level of complexity in the management of departmental infrastructure. For example, military tradesmen, supervisors and managers are employed extensively and gainfully in infrastructure activities to obtain the training essential to support military operations in Canada and abroad. The need for shore billets to train and rest military personnel required for deployed infrastructure activities also limits the Department's ability to employ private sector infrastructure management practices. Nevertheless, the Department is committed to increasing the use of business case methodology to determine optimal infrastructure management practices, with particular emphasis at the base level.*

27.66 The Government of Canada and National Defence should look to other countries for areas and methods of introducing competition for support services.

Department's response: *The Department of National Defence will continue to make use of the vast repository of information available, both nationally and internationally, on both public and private sector experience with streamlining and contracting out support services.*

Management of married quarters needs to be streamlined as soon as possible

27.67 Management has been fragmented. The Department owns approximately 22,000 dwellings, and leases an additional 2,000 units under bulk leases from the private sector, to house Canadian Forces personnel and their dependants at 36 bases and stations. The Minister's Task Force on Urban Infrastructure appraised the current market value of the 7,000 urban permanent married quarters at about $330 million. No market value has been established for the entire housing portfolio, but the Department estimates that it would cost $2 billion to replace it. Since 1960,

Current operating losses to the Crown are $30 million per year.

Treasury Board has forbidden the construction of permanent married quarters in urban and semi–urban areas. The portfolio is ageing, and most base housing is 30 to 40 years old.

27.68 There is no single departmental manager for married quarters. At least five sections of National Defence Headquarters share responsibility for married quarters, with similar fragmentation at the base level. The current yearly operating loss to the Crown reaches approximately $30 million (Exhibit 27.2), despite the fact that the Department does not make mortgage payments for the land and buildings. Until this year, the Department had not set an objective of financial self–sufficiency for its family housing.

The overall cost to the taxpayer of losses on married quarters amounts to $2.4 billion since 1978.

27.69 As revenues for married quarters are netted against the total departmental budget, base officials tend to view the operation of married quarters as purely an expense.

Operating losses have been significant

27.70 National Defence conducted an in–depth evaluation of married quarters in 1979. The study pointed to high costs and recommended divestiture of 15,000 units and the transfer to the provinces of base schools for occupants of married quarters. The Department did not follow the recommendation for divestiture of the housing, but initiated the transfer of schools in 1985 and will complete it in 1994. Net yearly excesses of expenditures over revenues for married quarters from 1978 to 1993 aggregate to $1.4 billion (in 1993 dollars), including outlays for dependants' education up to the 1985 decision to transfer the schools. If the amounts of the annual losses had been applied to reducing the public debt, including interest the taxpayer would have saved $2.4 billion from 1978 to 1993.

27.71 We found the following reasons for the losses:

- Total annual costs are about $5,000 per unit including grants in lieu of taxes

Married quarters at Comox – DND owns 22,000 family housing units scattered across the country on 36 bases and stations (see paragraph 27.67).



Aerial view of CFB Comox, B.C.

paid by Public Works and Government Services Canada. This is higher than a "self–help" housing co-operative at one Canadian Forces base, even though the self–help units include heat and hydro in their costs and permanent married quarters do not.

- Defence administration and maintenance costs for married quarters are 206 percent higher than for 14 non–profit housing co-operatives who are members of the Co-operative Housing Federation of Canada, and 250 percent higher than those of a private sector firm selected for comparison (Exhibit 27.3).

- Treasury Board requires that rents be comparable to those in the local housing market. We found that overall revenues are low due to vacancies and, in many cases, lower than market rents. Vacancies cost the Department about $8 million each year. The Department requires 30 days on average to prepare a unit for occupancy, while private companies estimate that they require less than one week. The Department has foregone an average of more than $25 million in revenue per year since the 1979 recommendation to divest. The amount exceeded $30 million in each of 1991–92 and 1992–93.

27.72 Internal audit reports indicate that revenues for bulk-lease housing at one base are inadequate to recover costs, due to vacancies, leasing arrangements at higher than market rates and strict voluntary compliance by the Department with provincial rent control regulations. The Department leases the units for $6 million each year plus some renovation and repair costs, but it collects only $3 million in rents.

Benefits are not well understood

27.73 The Department originally provided housing because salaries were low and bases were in isolated locations. Canadian Forces members now receive compensation parity with the public service, and urban growth has enveloped many bases while others are close to sizeable communities. The Department now lacks a proper rationale for its requirement for married quarters. In 1990 the Vice–Chief of the Defence Staff approved a statement of requirement for urban housing. It said only that members should have access to adequate housing at affordable costs and made no mention of military benefits. Departmental officials also claim that having a stock of family

The Department bulk–leases units for $6 million each year but collects only $3 million in rents.

Exhibit 27.2

Annual Operating Losses on Married Quarters Are Continuing



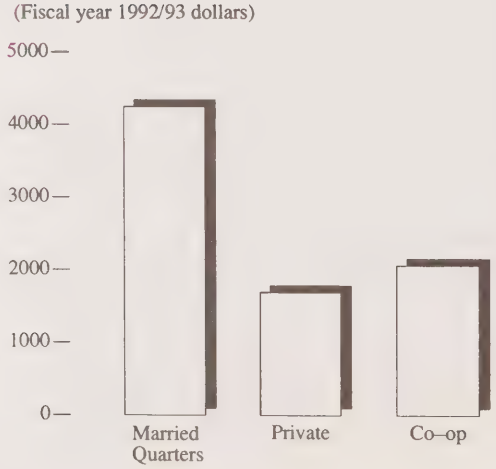
housing at each base protects the Department against extreme shortages or inflated prices in any given locality.

27.74 Officials said they believe that married quarters are important in supporting a military community and maintaining morale during deployments. Forces members and dependants face periodic separations due to training and deployments, which may occur unpredictably and at short notice. Officials also said that Francophone families living in Anglophone communities benefit from the additional community support of married quarters.

27.75 The Department has never formally assessed whether military housing results in actual military or social benefits. We decided to compare data on all the married non–commissioned members, or those living with dependants, enrolled between 1976 and 1992 who had never lived in married quarters with data on a similar group who had lived in married quarters during 80 to 100 percent of their careers. We wanted to determine if we could detect differences in morale, discipline, health and commitment to a career in the Canadian Forces.

Exhibit 27.3

Annual Unit Costs for Maintenance and Administration Are High for Married Quarters



27.76 Our study was sufficient to determine the following possible benefits to the military:

- members who lived in married quarters stayed in the military significantly longer than those who did not; and
- although there was no difference in the incidence of stress–related diseases, members who lived in married quarters were less likely to be hospitalized.

27.77 In comparing the two groups of personnel, our study also concluded that:

- there was no difference in discipline problems that involved days in custody;
- the proportion of Francophones in married quarters outside Quebec was approximately the same as that of Anglophones living in married quarters on the same bases;
- there were no significant differences in performance, health or discipline among members of peacekeeping expeditions from 1976 to 1992; and
- there was no significant difference in the job performance ratings of both groups.

27.78 Benefits may exist, but further study is required to determine their precise nature and their military and financial impacts. We did not attempt to assess whether the same benefits could be achieved through other, less costly means.

The Department is moving to address the problem

27.79 As we have noted, the Department has been aware for decades that it was incurring significant operating losses on its housing. During our audit, the Department began an initiative to establish a special operating agency to manage the married quarters. This initiative is designed to:

- place married quarters under a single manager;

- install cost management systems thought to be not feasible in the Department's own management system; and

- develop a business plan and operate married quarters on a self–sustaining basis by 1997–1998. However, the planned self–sufficiency does not account for capital requirements for major investment, grants in lieu of property taxes, or all accommodation subsidies paid to Canadian Forces members living in departmental married quarters.

27.80 At the time of writing, the special operating agency had not yet been approved by Treasury Board, but the Department had already begun to develop the business plan. The final structure and powers of the agency must be approved by Treasury Board once the business plan is completed. We caution, however, that:

- the ability of the special operating agency to break even and to satisfy Canadian Forces members' requirements cannot be assessed until a business plan is developed in two years;

- if there are delays in Treasury Board approval of the special operating agency, further losses will accumulate during this time;

- as part of the development of the business plan, the Department intends to review the potential for the properties at each base and to consider organizational options other than the special operating agency. Such options could include outright sale of all or some of the housing at a base, self–help housing, or a separate management contract with Canada Mortgage and Housing Corporation or a private property manager to manage the housing at a particular site. That review will be crucial to the future of military housing; and

- the Department needs to specify clearly how it will report the operations of the special operating agency to Parliament.

27.81 National Defence should study the military and financial benefits of married quarters and relate them to program objectives.

Department's response: *Concur.*

27.82 National Defence should maintain a sense of urgency in its action to end operating losses to the Crown on married quarters. The business planning for the special operating agency should include a full comparison with local alternatives, such as co-operative housing or sale of some properties.

Department's response: *Concur. The Canadian Forces Housing Authority (CFHA) has been established within the Department for this purpose and is well under way to implementation. It has already assumed some of the responsibilities for planning and forecasting needs for family housing. The CFHA will be reporting to the Deputy Minister and its operations will be reflected in Part III of the Estimates. However, the Department does not intend to report CFHA activities directly to Parliament (paragraph 27.80, last bullet). This is not the rule for any of the 15 special operating agencies that currently exist in the federal government.*

Non–public fund facilities require cost controls

27.83 As well as married quarters, the Department supports recreational and community facilities for military and family needs. Costs are shared by the Crown and the military community through "non–public funds". The original guidelines on non–public fund facilities state that they are to be operated "at minimum public expense". Treasury

Board stopped monitoring those departmental expenditures in 1984, relying on a departmental undertaking to do so.

27.84 We counted at least 36 types of non–public fund activities or facilities that receive public support, including community centres, day care centres, playgrounds, squash courts and rod and gun clubs. They receive some portion of the costs of utilities, materials, construction and administrative support. The Department could not tell us the extent of its total budgetary support to those facilities. The Department is not living up to its 1984 undertaking to monitor the use of public resources. It cannot say whether the facilities are being operated at minimum public expense.

27.85 National Defence should monitor the cost to the public of non–public fund activities, and use the information in its budget process.

Department's response: *Concur. The total cost to the Department for the provision of utilities, maintenance, construction and administrative support for personnel support program facilities and activities will be captured. At this time, however, these costs cannot be aggregated into a separate budget line item under the current Department of National Defence budget process. These expenses, although not separately identified, are part of each base's total expenditures and are integrated into the base budget. The Department is conducting a strategic review of all aspects of the personnel support program. The resulting strategic plan will ensure that the public receives value for its money and that public support meets, but does not exceed, the Department's obligations as a good corporate employer.*

Environmental Programs Need to Be Reviewed

The Department has clean–up plans

27.86 Military activities have the potential to cause environmental damage. Past activities, such as fuel storage and transfer, training exercises and garbage and sewage disposal, have contaminated areas on many bases. Those sites must now be stabilized or cleaned up. When bases close or when new uses are made of property, the Department's policy is to comply with the highest standards of federal and provincial environmental laws and regulations on clean–up. It cannot dispose of individual buildings or properties without respecting environmental concerns.

27.87 Current activities must comply with regulations. The Department is responsible for complying with the same laws as the rest of the federal government. It is taking steps to develop and implement an environmental management system; it has developed a policy and a multi–year program for both preventative and remedial aspects of environmental management. Environmental audits of many bases have been completed. Environmental officers, command strategies, manuals, directives, operational reviews, training courses and communication plans are in place or being developed. The Department's objective is to integrate sound environmental practices into its operational management. The Department intends to allocate $50 million per year for at least the next five years to clean–up activities. This amount does not include any major projects of over $10 million. National Defence will receive no additional funding for clean–up purposes. The Department has reported its plans and

initiatives to the Department of the Environment.

Costs have been underestimated

27.88 The Department has carried out environmental audits at 27 of 35 bases, which the Department calls "baseline studies". The best estimate from those studies of clean–up costs on the 27 bases is $203 million, although much more detailed work would be necessary to produce an accurate costing. The estimates assume no change in the use of the properties. If the use of a particular site were to change from industrial to residential, for example, clean–up standards and costs could be much higher. National Defence did not use the studies to estimate overall costs and to plan resources for its clean–up program. Instead, it used a much lower arbitrary estimate for clean–up of soil contamination only. The studies' cost projections were preliminary and were not based on detailed engineering estimates, which would require extensive sampling of soil and water. However, in our opinion, they are the best estimates available and are adequate for long–term planning.

27.89 We compared the cost of completed clean–up work with estimates made before the work was begun. We found that actual costs generally were higher. For example, the cost of cleaning up 102 underground storage tanks was 45 percent higher than estimated (Exhibit 27.4).

27.90 We did not expect estimates to be exact. However, we did expect officials to use historical data and to make provisions for estimation errors when planning their budgets. We recognize the difficulty of predicting clean–up costs accurately without detailed engineering studies. However, without using the best estimates available and analyzing past experience, the Department cannot plan and report properly.

27.91 Using the baseline studies and other best estimates, we calculated the potential costs of clean–up at over $700 million. Exhibit 27.5 shows the main items making up this amount. The Defence Early Warning (DEW) line clean–up estimate of $244 million assumes some financial co-operation from the United States government, although no agreement has yet been reached. Officials told us that there is no legal requirement to clean up the DEW line sites.

27.92 The Department now estimates that it cannot complete the clean–up of its properties in ten years by spending $50 million per year, as originally planned. Its projection of time required is now 15 to 20 years, although it has yet to work out its clean–up plan by matching available resources to best estimates of costs. The Department has not yet produced an environmental action plan, which must be made public.

Management information and accountability need to be improved

27.93 Performance reports on the environmental program produced for senior management are relevant and understandable. However, much information is not provided, including environmental risks, obligations and potential costs. Although there are guidelines on what should be considered an environmental project, it is often difficult to distinguish what is and what is not part of the environmental program. For example, unexploded munitions, projectile fragments and scrap metal must be removed from the Sarcee Range at Canadian Forces Base Calgary. That project, although significant, is not accounted for in the environmental program, even though senior

The Department intends to allocate $50 million per year to clean–up activities, although it will receive no additional funding for that purpose.

The Department now believes it will take 15 to 20 years to finish the environmental clean–up.

Military activities have contaminated bases and stations. DND has recently introduced a preventive environmental management policy (see paragraphs 27.86, 27.88).

Unexploded shells are a major concern (see paragraph 27.86).

Firefighting training can contaminate soil (see paragraph 27.86).

Safety systems technician venting the liquid oxygen (see paragraph 27.86).

Removal of soil contaminated by firefighting training at CFB Ottawa – courtesy of the Ottawa Citizen, Ottawa, Canada (see paragraph 27.88).

management's Program Control Board has referred to it as an environmental issue.

27.94 Failure to include all clean–up and prevention projects in the environmental program means that budgets for environmental actions are not aggregated, controlled and reported to senior management on a consistent basis, with a clear line of accountability. It means that senior management cannot assess the feasibility and true progress of its entire environmental program. Nor can it properly assess whether overall spending on environmental issues puts defence capability at risk.

27.95 The Department's report to Parliament in Part III of the Estimates does not include information on the multi–year environmental program. The Department does not report the time estimated for achieving the clean–up, or the total estimated cost. Officials indicated to us that they intend in future to provide more complete information to Parliament.

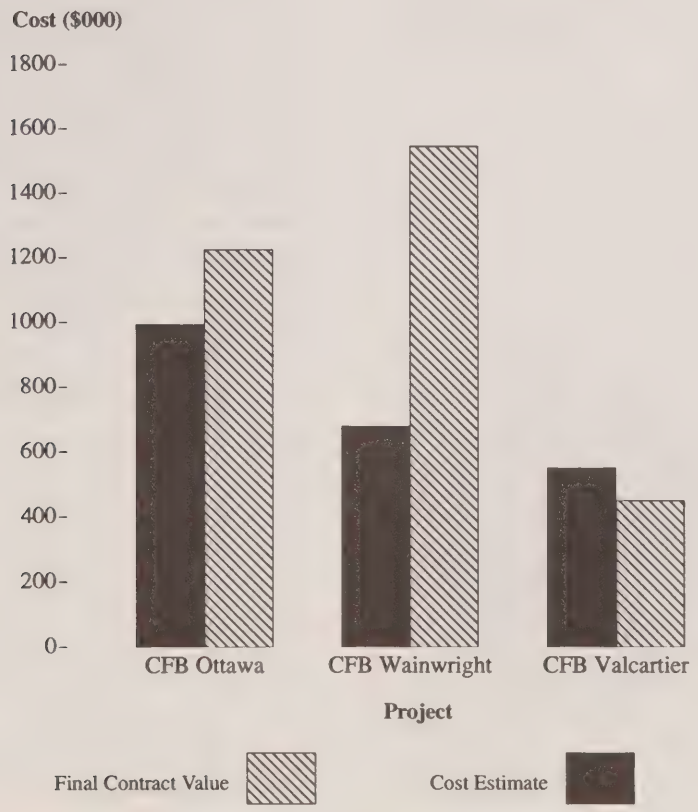
27.96 Departmental plans and budgets should recognize all costs that have been identified by departmental studies and should include an allowance for errors in estimation. There should be clear accountability for achieving all levels of environmental plans.

Department's response: *Concur. The Department has become aware that costs for clean–up have been higher than estimated due to uncertainty in the actual scope of contamination before site work begins. This will be allowed for by adding risk factors to the estimates provided by*

Exhibit 27.4

Clean–up Costs Can Escalate

Underground Storage Tank Project Costs



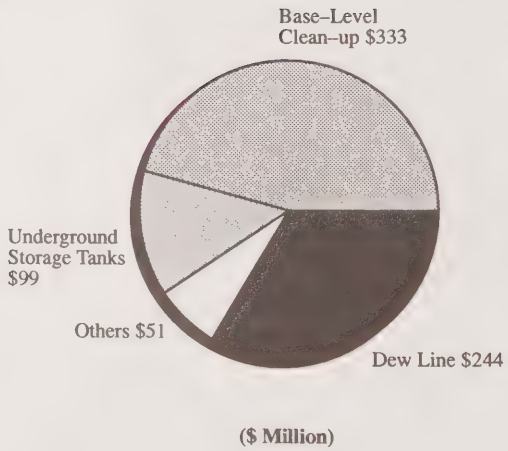
consultants. Clearer delineation of responsibility for different aspects of the environmental program will be included in the next annual submission concerning the program.

27.97 The Department should report both its plans and its progress in Part III of the Estimates. The reporting should explain the aggregate clean–up cost estimate and its potential impact on operations.

Department's response: *Concur. A statement concerning the Incremental Environmental Program will be included in Part III of the 1995–1996 Estimates. It will indicate the annual requests that represent the demand for resources as well as an estimate of the findings of the many departmental environmental audits. The resulting deferred liability will be tempered by the Department's new risk management approach to site remediation. That is, where contamination is not likely to immediately impact the environment or people's health it may be monitored/managed over the long term rather than cleaned up.*

Exhibit 27.5

Best Estimates Available Show the Cost of Environmental Clean–up at $727 Million



Weak Accountability Contributes to Excess Costs

Current information systems do not support accountability and life-cycle management of real property assets

27.98 We examined the Department's three major information systems supporting infrastructure management: a property record system (CEMIS I), a base–level work control system (CEMIS II), and a maintenance effectiveness tracking system (MES). We found that they are not oriented toward providing the information needed to manage discrete infrastructure elements over extended periods. Effective life cycle management requires such long–term information.

27.99 The CEMIS I satisfactorily provides basic information to users at NDHQ, to parliamentarians and to central agencies such as the Bureau of Real Property Management. However, it provides little or no physical information on the components that make up buildings and very little information on their current state and life expectancy. An adequate information system supporting life cycle management would track detailed physical information. Inspectors gather data on building component systems, but these data are not consolidated and used for life cycle planning of each facility. No one person can be expected to know the physical state of any entire building.

27.100 CEMIS II performs adequately as a Canadian Forces base–level system for tracking maintenance activity. However, it does not provide historical cost information on the operation and maintenance of a facility, nor can it be used to develop plans for future activities. For example, individual structures are not routinely metered for utility use; nor is this information, when available, tracked by the current system. Previous years'

maintenance information is retired after two years. The military's practice is to post key infrastructure decision makers every three years. This means that, in the absence of well–documented information, the corporate history that key managers acquire about a structure can be lost. While long–term information is necessary for major infrastructure items, practical considerations remain for smaller facilities, such as garden sheds. It would not likely be cost-effective to collect data for the entire departmental inventory. Similarly, the cost of installing monitoring devices such as utility meters may outweigh any benefits achieved. The Department cannot be expected to collect long–term information for every facility where not cost–effective.

27.101 Information systems do not support infrastructure budgets based on actual infrastructure requirements and historical costs. We found that ratings generated by the maintenance effectiveness system are open to manipulation, do not differentiate among the benefits of spending on various infrastructure, and are not based on consistent, reliable and current information.

27.102 The Department recognizes the limitations of its current information systems. It is trying new systems that it hopes will move toward solving these problems and support the departmental goal of managing according to activity–based business plans.

27.103 The Department, where appropriate, should implement information systems that support the life cycle management of individual structures, building systems and works.

Department's response: *The Department is currently fielding an information system that can be used to support the life cycle management of individual facilities. The Department does meter the utilities for all new major facilities.*

Diffusion of accountability and responsibility leads to unnecessary costs

27.104 We noted accountability issues in several of the areas we examined, including permanent married quarters, productivity at the base level and grants in lieu of taxes.

27.105 At the base level, responsibility for maintenance support is divided. At most bases there is a Transportation Section separate from the Construction Engineering function. Construction Engineering tradespeople use base transportation extensively to get to job sites, but no cost is imputed to the jobs. The Air Command Socio–Tech initiative found that the average tradesperson wasted 155 minutes daily waiting for transportation to and from the job site. By allocating vehicles to the tradespeople at Canadian Forces Base Shearwater, the Department calculated that an equivalent of $528,808 in labour time was shifted from waiting for transportation to doing productive work. The improvement trial at Base Borden resulted in net annualized productivity savings of $418,000 by providing vehicles directly to the tradespeople. We estimate potential benefits of approximately $10 million annually if the Socio–Tech and Training System base solutions were implemented at all bases.

27.106 Grants in lieu of taxes are paid to municipalities under the *Municipal Grants Act*, administered by Public Works and Government Services Canada. The 1992 estimate of grants in lieu of taxes for National Defence properties was close to $110 million for municipal and school services. National Defence currently incurs direct production costs for various municipal-type services such as

recreational services, firefighting and protection, garbage removal, sewage disposal, snow removal, road maintenance and street cleaning. At the same time, federal grants in lieu of taxes are paid by Public Works for similar services at the same locations. A review at four bases shows that Public Works is paying the same rate for National Defence property as the taxpayers in the municipality, even though National Defence is providing many of the same services itself in order to meet its own standards.

27.107 Although base commanders are instructed to eliminate duplication, they do not control a significant portion of base expenditures for municipal–type services provided by the Department. As well, Public Works is responsible for payment of grants in lieu of taxes and for negotiating those grants with municipalities. Any contact between the base commander and Public Works with a view to negotiating with municipalities must be made through National Defence Headquarters. Such a framework renders difficult close co-operation with the municipalities.

27.108 We reviewed the payments of grants in lieu of taxes for four bases and found that the overlapping services provided by the municipalities and the base in the areas of police and fire protection, garbage collection, recreational services and water and sewage represented, on average, 30 percent of the municipal expenditures. Under the *Municipal Grants Act*, the municipalities are required only to provide the same level of service to the bases as they do to other ratepayers. Although the grants are at the discretion of the Minister of Public Works and Government Services, Public Works officials consider that the Act provides no justification for negotiating grant amounts based on the level of services required by a base. However, especially at bases located in urban areas, we believe there is room for potential savings through more co-operation and negotiation with the municipalities.

27.109 In our opinion, the Crown could save on payments of grants in lieu of taxes and on duplication of services if National Defence controlled the budget for grants in lieu of taxes on its properties. Another alternative would have Public Works charge National Defence for grants paid on its behalf. Either approach would allow the Department to have direct responsibility for the total cost of services provided. The Department could then play a greater role in negotiating arrangements with the municipalities and reduce overlapping payments or services to a minimum. At present, neither National Defence nor Public Works can be held accountable for lack of economy in this area.

27.110 National Defence should ensure that its business planning initiative provides a strong accountability framework to match delegation of authorities.

Department's response: *Concur. The Department's demonstrated commitment to business planning will continue through the auspices of Defence 2000 and associated initiatives. The stated aim of the Base DelegAAT trial — "to delegate authority and assign accountability to Base Commanders" — amply illustrates the Department's recognition of the need to directly link accountability to delegation of authorities.*

27.111 The departments of National Defence and Public Works and Government Services should jointly review the legislative and administrative frameworks for the grants in lieu of taxes paid for defence properties, with a view to clarifying accountability,

ensuring maximum co-operation with municipalities and minimizing overlap of services provided by National Defence and the municipalities.

Department's response: *Departmental officials are already working on this issue with their counterparts in Public Works and Government Services Canada. Initial efforts will be focussed on an accountability structure within existing legislative and administrative frameworks while identifying and rectifying any overlaps of services provided by municipalities.*

Public Works and Government Services Canada response: *PWGSC concurs that closer co-operation between itself and the Department of National Defence on grants in lieu of taxes is desirable. It is already being actively pursued by the two departments.*

It should be recognized, however, that issues connected with accountability for grants are not restricted to DND. The decentralization of this responsibility to custodian departments has been under discussion for more than a year between Treasury Board Secretariat and PWGSC (refer to Departmental Responses at Chapter 12). As you have noted, changes in Ministerial responsibility for this program may well require legislative amendment.

In respect to the concern expressed in regard to the quantum of grants on properties where a quasi-municipal infrastructure is self-provided by the Government of Canada, this issue will be considered in the context of our overall review of the program.

Overall Conclusion

27.112 National Defence senior management is attempting to introduce up–to–date management concepts and practices in all departmental activities. It recognizes the important cost consequences of continuing to hold and operate infrastructure that is no longer appropriate to its current and planned programs.

27.113 Our audit found that, overall, National Defence has the opportunity to make significant improvements in the management of its infrastructure. There is an urgent need for the Department to focus attention on the management of its real property portfolio. Managers across the Department need to work together to provide the right number and types of properly maintained buildings and properties to support key defence activities effectively, for both peacetime and emergency requirements.

There is an urgent need for the Department to focus attention on the management of its property portfolio.

27.114 The business planning process being implemented by National Defence senior management will have to organize activities and delegate resources, authority, and accountability for infrastructure decisions to the appropriate positions in the Department. To safeguard departmental resources for military capability while meeting expected budget reductions, senior management will need to reward management behaviour that supports the objectives of economy, efficiency and effectiveness at every stage of life cycle property management.

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to the House of Commons

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The audit work reported in this volume was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

Chapter 28

Revenue Canada

Customs Assessment Activities

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Revenue Canada

Customs Assessment Activities

Assistant Auditor General: Shahid Minto
Responsible Auditor: Jim Ralston

Main Points

28.1 Canada collects about $4 billion a year in customs duties. At the start of our audit, Customs had recognized that the existing assessment system was overburdened and inappropriate for today's rapidly evolving trade environment. Our review found ample evidence that the system is overburdened. Customs officers are unable to deal with the 21,000,000 transactions processed each year. Of these, about 8 percent are reviewed. In our opinion, this review is inadequate and allows importers to pay less than the required amounts of duty.

28.2 Customs is addressing these problems by developing a new way of working called the New Business Relationship (NBR). This project is an ongoing attempt to redesign the relationship between Customs and its clients. We looked at two specific NBR initiatives that related to customs assessment and found them to be innovative and useful to clients who used them. The more important of the two initiatives—periodic verification—has just passed through the pilot stage. This initiative, which addresses the concerns of large importers, now must be widened to include more companies.

28.3 Another area of concern involves origin and end–use audits. Under free trade agreements, importers must present a certificate declaring that the goods being imported fall under the rules of origin. We believe that these certificates could be more thoroughly checked. We also found that not enough audits of preferential end–use provisions were being done. A final area of concern is the appeal process, which, due to legislative constraints, we found to be slow and cumbersome.

Introduction

28.4 The purpose of customs duties in modern times is to regulate trade relations between Canada and the rest of the world. This is in contrast to their purpose 125 years ago, when customs duties were primarily a source of revenue. Even though it might be said that revenue collection is now incidental to trade policy administration, revenue from custom duties remains significant. The Customs Branch of Revenue Canada must balance its roles as both a revenue collector and an administrator of trade policy.

28.5 In 1993–94, net customs duties amounted to $3.7 billion. Over the last 10 years, revenue from customs duties has remained relatively flat, fluctuating between $3.7 billion and $4.6 billion (Exhibit 28.1). During this time, revenue from customs duties has become an increasingly smaller portion of government revenue, dropping from 5.6 percent in 1984–85 to 3.1 percent in 1993–94.

28.6 This trend is the result of a move toward freer trade. In the last five years, Canada has been a partner in several initiatives that have fostered freer trade.

28.7 The most significant are the Free Trade Agreement between Canada and the United States, which took effect in 1989, and the recent North American Free Trade Agreement between Canada, the United States and Mexico, which came into effect in January 1994. One result of these two agreements has been reduced customs duties. This is especially significant since 67 percent of imports to Canada come from the United States. Mexico makes up another 2 percent of imports to Canada.

28.8 Canada is also a signatory to the General Agreement on Tariffs and Trade (GATT). The most recent round of GATT negotiations, completed in 1994, continued the trend of reduced tariffs.

Work in Previous Years

28.9 Customs divides its work among three main components (Exhibit 28.2):

- border services
- trade policy administration
- assessment and collection of duties and taxes.

28.10 Over the last three years, we have reviewed significant portions of activity relating to two of the three lines of work. In 1991, we reported on certain aspects of Customs activities relating to border operations. Our audit included departmental operations relating to personal travel at border crossings, release of and accounting for commercial goods, illegal drugs and hazardous material. In 1992, our Office commented on the Customs trade policy administration that deals with Canada's anti–dumping and countervail program. In 1993, we reported on Customs' role in collecting and verifying merchandise trade data.

28.11 This year's audit reports on the assessment of duties for commercial goods. Customs assessment activities ensure that the appropriate amount of duties has been calculated.

The purpose of customs duties in modern times is to regulate trade relations.

Audit Objective and Scope

28.12 The objective of our audit was to review Customs activities relating to the assessment of commercial goods. We also reviewed the Department's mechanism for ensuring that importers comply with Canadian legislation and international trade agreements relating to the assessment of commercial goods.

28.13 The main areas of review were the systems used by the Department to record and verify that the appropriate amount of duty has been assessed on commercial goods imported into Canada. To do this, we looked at departmental procedures for ensuring that:

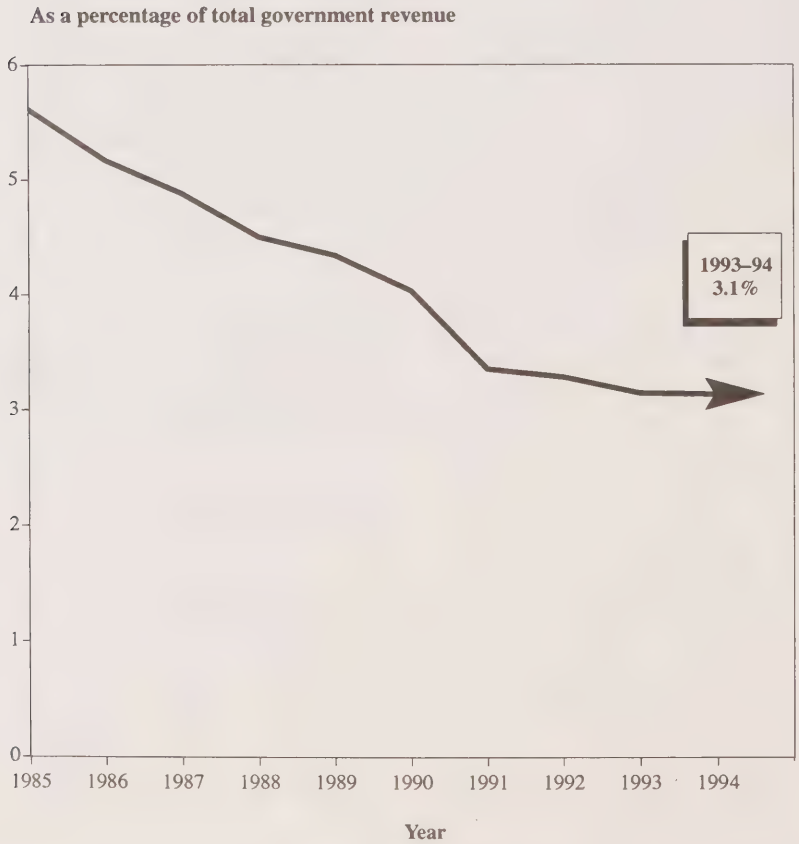
- the proper quantity and value were determined;

Exhibit 28.1

Customs Duties Are Decreasing

Free trade agreements such as NAFTA and GATT will accelerate these trends.





Source: Public Accounts of Canada

- the originating country was accurately identified; and

- the correct classification was applied and the right rate of duty was charged on the goods.

28.14 We also reviewed two programs related to refunds and exemptions of import duties. The first program refunds duties paid on imported goods that are used or disposed of in accordance with certain provisions. These repayments of duties are called drawbacks. In the other program, goods imported to Canada are not charged duties at the time of entry because they are to be used for specific manufacturing purposes. These exemptions from paying duty are called end–use provisions. A portion of our audit looked at Customs' mechanism for ensuring that importers have complied with end–use provisions. In addition, we reviewed the departmental system for handling appeals.

28.15 Our audit work was conducted at Customs' head office and regional offices. The bulk of customs assessment work is carried out in the 10 regional offices. Headquarters in Ottawa is responsible for the overall administration and policy setting relating to customs assessment. Our audit criteria appear in Exhibit 28.3.

28.16 In each region, the customs assessment work is carried out mostly in the Customs Assessment Division. In 1993–94, these regional divisions spent almost $48 million and used 1,250 person–years.

Overview of Commercial Importation

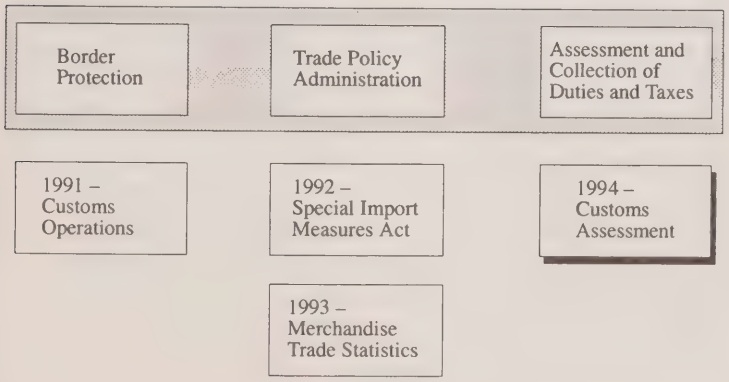
28.17 The importation of commercial goods involves two steps. The first step is the release of goods by Customs inspectors at the border. This release is done after collecting and reviewing documents that detail the type and amount of commercial goods entering the country. In some cases, a physical examination is done to verify the information provided. This step is a border services activity, which is outside the scope of this audit.

28.18 The second step is the assessment of duties, which is the focus of the present audit. Assessing the appropriate duties to be collected on imports involves verifying the tariff classification, the country of origin and the value of the goods. This work is primarily done at the regional Customs office and is described in more detail in paragraphs 28.21 to 28.24 (see also Exhibit 28.4).

28.19 There are several other activities that are necessary to ensure that the proper amount of duties is collected. Some importers can recover the duties paid through the various duty–relief programs.

Exhibit 28.2

Main Components



Customs verifies duty–relief claims to ensure that the importer is eligible. Other importers do not pay the duty up front, as they are eligible under the end–use or other relief provisions contained in the *Customs Tariff Act*. Again, Customs verifies a sample of these entries to ensure that each importer has complied with the conditions set out in the legislation.

28.20 An importer who disagrees with a departmental decision relating to classification, valuation or origin of goods may appeal. The *Customs Act* provides a multi–level appeal process to resolve these types of disputes.

Observations and Recommendations

Assessment Procedures

Almost one in five tariff classifications is in error

28.21 In 1993–94, Customs processed over 8 million commercial entries with a total reported value of over $183 billion. Some of these entries have more than one type of commodity. Each commodity is accounted for separately in individual transactions called lines. In 1993–94, the Department processed over 21 million lines of transactions.

28.22 These lines are submitted to Customs by the importer or broker on an accounting document. The accounting document details the tariff classification, the value of the goods being imported and the amount of duty owed.

28.23 The lines are selectively reviewed by Customs officers who are specialists in a particular type of product. In 1993–94, 8.1 percent (1.7 million) of lines were selected for review. Items are selected on the basis of various criteria that take into account the risk, value and nature of the transaction. Line reviews are conducted by going through the documents submitted by the importer or broker to the regional office to support the accounting document. This procedure is called a desk review.

28.24 Current legislation calls for Customs to review the accounting document within 30 days of its receipt. If the Department does not make an adjustment within 30 days, the accounting document submitted by the importer is considered correct. In verifying the commodity's tariff classification, the Customs officer compares the classification declared by the importer with the documents provided. If further information is required, the officer contacts the importer by telephone or in writing. The Customs officer does not see the actual imported goods.

28.25 A recent internal audit reviewed a sample of accounting documents submitted by importers. The auditors looked for one particular type of error – a tariff classification error. On a typical accounting document, the importer

Exhibit 28.3

Audit Criteria

- Systems, procedures and practices should ensure that liability for duties on commercial goods imported into Canada is properly assessed and that refunds, where appropriate, are made in an economical and efficient manner and in compliance with legislation and international trade agreements.
- Systems, procedures and practices should ensure that adjustment requests and appeals are processed in an efficient and effective manner.
- The Department should have appropriate procedures and standards in place to ensure that a high quality of service is provided to its clients.
- Management information systems should provide reliable, relevant and timely information on operations.

indicates the tariff classification that it believes is appropriate for the imported good. The tariff classification determines the rate of duty to be paid. The internal audit found an error rate of 19 percent in tariff classification alone. Not all classification errors have a revenue impact. For example, the tariff classification might be in error, but if the correct tariff classification had the same tariff rate, there would be no revenue impact. The internal audit did not calculate the revenue impact of the errors noted.

28.26 The error rate discovered by internal audit is approximately four times higher than the combined rate of errors in classification, valuation and origin found by Customs officers. In 4.4 percent of cases, Customs officers issued adjustments to correct errors such as classification, value or country of origin. The 75,000 adjustments generated $80 million in additional revenues for the Department.

28.27 One reason for the discrepancy between the internal audit findings and the error rates found by Customs officers may be the large volume of work. Customs officers are often overloaded and have a hard time reviewing the transactions sent to them within the legislated time frame. Often, the officers resort to an "expedited" review, which means that they will quickly check transactions that are about to exceed the legislated 30–day rule. If there are no obvious errors and the risk seems minimal, no further work is done and the transaction is declared correct.

Compliance Verification units were created to deal with revenue losses

28.28 While not all classification errors have a revenue impact, the relatively low rate of adjustments found in the normal transaction review process compared to the estimated error rate found in the internal audit suggests a potential for large revenue losses. This was confirmed by Compliance Verification units that were created in 1992 to perform additional testing to supplement the normal transaction review process. The creation of the units was a departmental response to a government initiative in deficit reduction. The additional resources provided through this initiative were used

Customs officers are often overloaded and have a hard time reviewing the transactions sent to them within the legislated time frame.

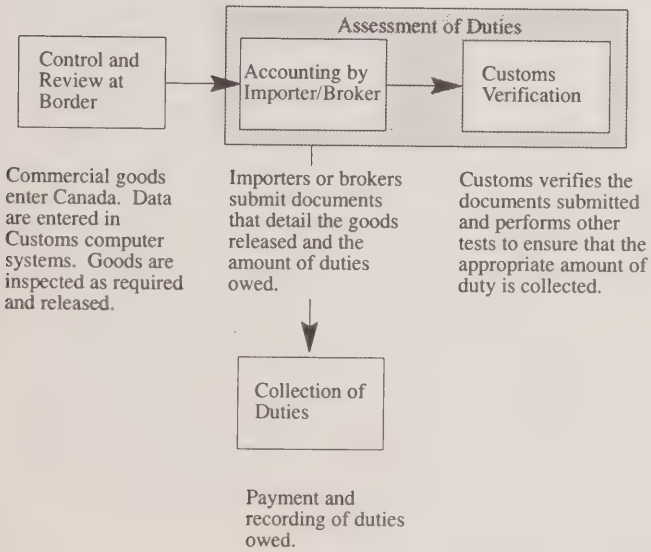


Exhibit 28.4

Flow of Commercial Goods

to generate additional revenue and reduce instances of non–compliance.

28.29 Since their inception, Compliance Verification units have generated $135 million dollars of revenue. Exhibit 28.5 gives the results and resources used by the units in the last two years. In 1993–94, they collected almost $6.5 in revenue for every $1 in additional costs.

A new review system is being tested

28.30 The Department has recognized that the present system of reviewing selected lines for detailed review is not working well. Recent work in the Compliance Verification units has shown that the transaction approach may not be the most effective for larger importers.

Since 1992–93, Compliance Verification units have generated $135 million in additional revenue.

28.31 A current departmental initiative, periodic audit, is one element of the Customs re-engineering effort known as the New Business Relationship Initiative (see Exhibit 28.6). Periodic audit deals with larger importers in a different way. Instead of looking at individual transactions for larger companies, the Department collects information on importers' systems, and samples transactions to determine the rate of their compliance with legislative requirements.

28.32 Periodic audit was first tried in two manufacturing companies. The audits found over $4 million in additional duties. In addition, many errors were found in tariff classification. Based upon this project, the Department decided in 1992 to extend periodic audit to other selected manufacturing companies.

28.33 Customs has completed the first round of audits for six companies in one industry sector. In a review of the tariff classifications for certain imported goods, approximately 55 percent of transactions were found to be incorrectly classified. Periodic audits in another industry sector were ongoing at the time of our review.

28.34 The error rates shown by some of Canada's largest manufacturing companies in the pilot study reflect the difficulty in making a proper tariff classification. The International Harmonized System has over 16,000 possible tariff classifications. This inherent complexity has been complicated by the major changes in Customs procedures in recent years as a result of the Free Trade Agreement and the North American Free Trade Agreement.

28.35 The pilot projects in participating industry sectors have shown that audits of very large companies are useful. Customs is able to obtain better departmental compliance and trade statistics while working more co-operatively with large importers. In some cases, participating companies have reported that their customs reporting procedures have been simplified and better integrated into existing operations. This will result in industry cost savings. One of the industry sectors involved in the pilot project estimated that it would save at least $100 million over the next 10 years as a result of the change in procedures. Participating companies have reported benefits in other areas, such as reduced release times at the border, elimination of unnecessary paperwork and improved client assistance. In all cases, the

Exhibit 28.5

Compliance Verification Resources and Results

(in millions of dollars)

	1992–93	1993–94
Results	$51	$84
Resources Used	$18	$13

companies welcomed the new initiative but felt that further modifications would be needed to realize the full potential for savings.

28.36 Customs now needs to translate the success of the pilot projects into new routines for doing business. Customs wishes to move away from a transactional review approach for as many as possible of the 150,000 importers it now deals with.

28.37 Regular periodic audits, like those performed in the pilot projects, are practical for only the very largest Canadian importers. For other importers, some other form of periodic verification is needed. This may involve audits at less frequent intervals, audits of industry groups rather than individual importers, or audits of information sent in to the Department rather than information gathered by the Department in a visit to the importer. The type of periodic verification chosen will depend on the value and risk of the transactions as well as the past record of the importer.

28.38 There is a tremendous range of activity among the 150,000 companies that import goods on an annual basis (see Exhibit 28.7). The top 1,000 importers account for 69 percent of the total value of imports to Canada.

28.39 Customs hopes by the end of 1995 to cover 40 percent of the value of total imports through some form of

Exhibit 28.6

New Business Relationship Initiative

The New Business Relationship (NBR) initiative is an ongoing project at Revenue Canada – Customs. NBR objectives and principles include the following:

- to offer Customs' commercial clients a new relationship that is based on their demonstrated compliance record with the Department;
- to revise the relationship so that importers are more responsible for their application of trade law, while Customs concentrates on providing effective advice, guidance and enforcement to support voluntary compliance and a level playing field;
- to improve the competitive position of Canadian business by maximizing the cost-effectiveness of Customs' commercial procedures and minimizing the cost, delay and intrusion that they cause to international trade;
- to tailor Customs' procedures to client business practices wherever practicable by eliminating the need for duplicate control processes and making electronic commerce the preferred option at all stages of the commercial process; and
- to improve Customs' ability to discriminate, at the first point of arrival, between admissible commercial goods and those that pose a threat to Canada's social, economic or environmental well-being.

The Department will implement these objectives and principles by moving from:

- a "one-size-fits-all" approach to a tailored option approach;
- a shipment-by-shipment focus to a client-oriented focus;
- a controlled environment to one that encourages self-assessment; and
- a transactional environment to a periodic environment.

The New Business Relationship is a Department–wide initiative. Therefore, some elements do not fall under the scope of our current audit. We have reviewed departmental efforts regarding periodic audit and the National Rulings Program as part of this audit.

periodic verification. However, the Department does not have a detailed plan at this time as to how many or which particular importers will be covered. It also has no detailed plan as to the type or mix of periodic verification strategies that will be used.

28.40 Customs should, in the continuing development of the New Business Relationship, develop more fully a strategy and plan for implementation of periodic verification for large importers. The plan should also articulate a strategy for addressing the verification requirements for other importers. Plans should specify a timetable for implementation.

Department's response: *A proposed plan of action spanning the next 18 months is in the approval process. This plan includes a small business strategy specifically designed to meet the particular needs of infrequent importers. In the interim, the plan will be refined and will be complemented by the development of a comprehensive implementation plan that will map out a longer strategic direction.*

Canadian businesses welcome Revenue Canada's New Business Relationship initiatives.

More end–use and country–of–origin audits are needed

28.41 An end–use provision reduces or eliminates the duty payment if certain conditions are met. For example, certain goods entering the country for manufacture are not charged customs duty. Annually, approximately 15 percent of all commercial transactions claim an end–use provision. A 1992 Customs study indicated that approximately $28 billion of commercial goods entering the country claimed an end–use provision. The net revenue not collected at time of

Exhibit 28.7

Importer Profile

Total of 1993-94 Imports
$183 Billion

	$ 46 Billion	$ 84 Billion	$ 126 Billion	$ 168 Billion
				
Number of Importers	10	100	1,000	10,000
Percentage of Total Imports	25%	45%	69%	92%

Source: Revenue Canada

importation from these goods was $2.7 billion. Customs verifies that the appropriate end–use provision was complied with through an end–use audit. An end–use audit verifies that the goods were actually used as required by the specific condition set out in the end–use provision claimed. If the goods have been diverted for other uses, the importer is required to report the diversion and pay the appropriate duties.

28.42 Our review indicates that limited work has been done by Customs to ensure that importers comply with end–use provisions. Regional offices have established end–use audit units in their investigation divisions. However, there are few resources allocated by Customs to end-use audits. In 1993-94, there were only 10 person–years devoted to end-use audits within the 10 Customs regional offices.

28.43 During 1993-94, this level of effort resulted in the completion of 141 reviews. These reviews produced an additional $4.9 million in duties assessed to importers. The Department states that in the future, end-use audits will be part of the review for companies subject to periodic verification under the New Business Relationship.

28.44 Customs is currently administering the North American Free Trade Agreement (NAFTA), which replaced the Free Trade Agreement between Canada and the United States as of 1 January 1994. We were unable to review the verification procedures that Customs is administering under NAFTA because the agreement is still new. However, we were able to review departmental efforts under the Free Trade Agreement. Under this Agreement, goods originating in the United States are accorded a preferential tariff rate. To obtain the preferential tariff, commercial importers must obtain a certificate of origin from the exporter. It is Customs' responsibility to ensure that the certificate of origin used by an importer is valid under the rules of the Free Trade Agreement. Our review of Customs' work relating to this area revealed two concerns.

28.45 First, past procedures for selecting certificates of origin for review were inadequate. In the initial stages of the Free Trade Agreement, Customs looked at the sensitivity of a particular industry, the differential rates of duty and complaints to determine which goods or industries to target for an origin review. Customs has started to refine its risk analysis based on the company profile and the type of industry and/or good imported. This risk analysis is now being used in the process of selecting targets for future audit work and should result in more effective monitoring in this area.

28.46 Customs' initial focus in regard to the Free Trade Agreement was to educate importers on their obligations under the new law and to thereby promote self–assessment. In recent years, Customs has increasingly emphasized reviews to ensure that certificates of origin are valid. Our audit indicated that even more work could be done in this area. The first step in reviewing an origin claim involves inspecting the certificate of origin and contacting the importer for more details if the information is not adequate. Customs may ask the exporter to complete a questionnaire to determine if the rules of origin apply to the goods in question. Depending on the response, Customs may request a visit to the exporter's premises to determine whether the goods are eligible under the rules of origin.

28.47 There are two types of visits to importers, depending on which provision of the Agreement is being claimed by the

importer. One type, called a verification visit, ensures that the tariff classification of the good being imported has been changed. In the second type, an importer may claim that a good qualifies under the Free Trade Agreement if at least 50 percent of the value of the good has been added in the United States. These more complex reviews, called audits, check manufacturers' records to ensure that the value–added provision has been met. In the last five years, ending 31 March 1994, a total of 40 audits were done on United States exporters and 106 verification visits were made with respect to tariff change rules.

The potential for country–of–origin problems has grown with the implementation of NAFTA.

28.48 The potential for problems has grown with the implementation of NAFTA in January 1994. Some of the rules of origin have become more complex, and goods from Mexico now also benefit from a preferential tariff. Audits of exporters and manufacturers in the United States and Mexico will continue to be necessary to ensure that only eligible goods are given the preferential NAFTA rate of duty.

28.49 Customs should review its audit strategy for both end–use and origin reviews. The level of audit review in these areas should be based on a comprehensive evaluation of both risk and compliance issues.

Department's response: *A review of the audit strategy for both end–use and origin is well under way within the Department. As acknowledged in the report, the Department is making efforts to correlate the level of verification with risk and compliance profiles in origin determination. Furthermore, the Department has recently assigned more dedicated resources to audit verification with the introduction of NAFTA.*

With respect to the end–use program, the Department is making organizational changes to ensure a better alignment of this program with compliance activities related to other trade administration verification activities. Both the origin and end–use programs will be further strengthened in the context of the New Business Relationship Initiative. As the current transactional focus is replaced with a client orientation, risk assessment and targeting will be based on an importer's compliance record, as well as the sensitivity of particular areas of trade.

Appeals

The appeal and adjustment process is seriously backlogged

28.50 There are several situations where an importer may be in dispute with Customs regarding the amount of duty owed. In some cases, an importer may disagree with a decision that results in greater duties owed. In other cases, additional information, such as a certificate of origin, may be required to gain a lower assessment or duty–free status. Sometimes, an importer realizes that an error has been made and wishes to voluntarily adjust the documents. All disputes must be handled through one formal appeal process.

28.51 This practice is a result of legislation stating that requests for changes to an assessment must be done through the appeal process. Customs is reviewing the possibility of handling corrections, errors and changes through a more informal dispute settlement process.

28.52 The use of the formal appeal process for all adjustments has resulted in backlogs and delays. At the end of 1993–94, disputed duties in the appeal process amounted to over $162 million. The first stage of the process is at the regional level. In 1993–94, regional offices received almost 300,000 appeals from importers. At 31 March 1994, there were 54,000 appeals outstanding at the regional level and the average length of

time to deal with an appeal was two months. At 31 March 1993, there were over 84,000 appeals outstanding at the regional level.

28.53 The second level of appeal is at head office. At 31 March 1994, there were 17,000 appeals at the headquarters level and the average time to issue a determination was 15 months.

28.54 The Department has recognized that the present legislation is inappropriate for many of the appeals currently in the system. At the time of our audit, Customs was reviewing its legislation to determine if a revised process for the more administrative matters would be appropriate.

28.55 Customs should continue with its efforts to separate administrative matters from its formal appeal process.

Department's response: *Revenue Canada agrees with the recommendation. The current* Customs Act *review process addresses this issue and, based on its recommendations, work is under way to draft new legislative provisions for redress and client–driven corrections to accounting transactions.*

Rulings

A new National Customs Rulings Program provides more certainty to users

28.56 Customs has developed a new program called the National Customs Rulings Program. This program was developed to respond to user concerns regarding advance rulings on goods to be imported to Canada.

28.57 Prior to 1992, Customs did not issue binding rulings to importers or brokers. Rather, an opinion would be given if requested. These opinions were regionally based, followed no national procedures or standards, were not binding and were difficult to apply. As a result, importers were unable to plan and conduct their business with certainty.

28.58 To deal with these problems, the National Customs Rulings Program was designed. The intention was to provide nationally consistent and binding rulings that would allow importers to do their business with greater certainty.

28.59 The Rulings Program allows importers to make written requests to regional offices. Once the rulings are issued they are entered into the Technical Reference System, which is a national data base. The main focus of the Rulings Program is on classification and, to a lesser degree, origin and valuation.

28.60 Customs completed a program evaluation on the Rulings Program in the fall of 1993. The program evaluation measured the success of the program against various performance standards, including the program objective of providing rulings within 30 days for regular cases and 120 days in complex cases. The report noted that the turnaround time standard was met in 92 percent of all the cases up to June 1993.

28.61 We asked for the same information updated to the end of March 1994. We found that, although the information was available at the regional level, it was not being gathered and reviewed at the headquarters level. As a result, management is unaware whether the program standards are being met. The Department has informed us that it is in the process of implementing a computerized management system that will give the necessary managerial information.

28.62 Customs should ensure that a management information system that gathers and summarizes regional results for the National Customs Rulings Program is implemented at the national level.

Department's response: *As stated in this report, the Department is in the process of implementing a computerized system that will give the necessary managerial information. The system is now being tested in two regional offices, Toronto and Hamilton. Testing should be complete and the system should be operating nationally before the end of 1994.*

Conclusion

28.63 The collection of activities that comprise Customs assessment are under severe strain. Customs officers are unable to cope with the volume of transactions. The introduction of periodic verification promises to ameliorate this situation for large importers, but the Department needs to determine how it will apply this strategy to other importers. End–use and country–of–origin audit activity is low, and the level of review should be adjusted to reflect both risk and compliance issues. The appeal process is backlogged due to statutory constraints, and changes need to be made to speed up the process.

Chapter 29

Revenue Canada

Collecting Income Tax Debts

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Revenue Canada

Collecting Income Tax Debts

Assistant Auditor General: Shahid Minto
Responsible Auditor: Basia Ruta

Main Points

29.1 In the last decade, Revenue Canada's goal, to stop or reverse the trend of growth in delinquent income taxes, has often proved to be unattainable. From 1988–89 to 1992–93, the Department experienced sustained growth in the dollar value of delinquent income taxes. This increase significantly outpaced the growth in net federal income tax revenue for that period. The Department noted that the recession and slow economic recovery have affected the ability of many taxpayers to settle their accounts in a timely manner. There was no year–over–year growth in delinquent income taxes in 1993–94; the value of these taxes remained relatively constant at the 1992–93 level.

29.2 In an effort to curtail the rising inventory of tax debts, Revenue Canada undertook a number of initiatives and increased the number of collectors in 1992–93 and 1993–94. Approximately 10 percent of the Department's Taxation employees work on collection activities, and about $100 million, or 7 percent of Taxation annual expenditures, are used to collect income tax debts.

29.3 On 31 December 1993, about 1.6 million taxpayers (mostly individuals, including the self–employed) owed income tax totalling $9.2 billion. At the time, 29,000 taxpayers had amounts in dispute. Unpaid income tax debts (net of amounts not immediately payable under "taxes in dispute" legislation) amounted to $6.5 billion. However, not all income tax debts are collectable.

29.4 The Department estimates that of the $6.6 billion outstanding on 31 March 1994, $1.1 billion might never be collected. In our view, Revenue Canada's methodology for assessing collectability of income tax debts tends to overstate the potential cash value of this asset.

29.5 The ratio of cash payments collected to value of accounts resolved has fluctuated over the past several years. Recently, it has decreased, dropping from 84 cents on the dollar in 1990–91 and 1991–92 to 79 cents in 1992–93. One factor affecting this statistic is the level of income tax debts written off in a given year. At current collection levels, for each one–cent drop in average cash recovery, there is a reduction of about $34 million in revenue. The Department forecasts that this ratio will increase to 81 cents in 1993–94.

29.6 The Department has a number of initiatives under way aimed at improving collection operations, such as the introduction of a single business identifier number for all accounts within Taxation, Customs and Excise and an on–line management information system for collection activities. The Department has successfully expedited payments on small balance accounts. Departmental records indicate that payments of $22 million in 1992–93 and an estimated $57 million in 1993–94 have resulted from this initiative.

29.7 Revenue Canada needs to further improve its operational and performance information to help ensure that tax collectors are handling accounts in a timely and productive manner.

29.8 The Fairness Package has been used to forgive interest and penalties on unpaid amounts in certain circumstances. Revenue Canada has neither kept records that would allow for the totalling of all adjustments nor adequately monitored the circumstances in which they were applied.

Introduction

29.9 Income tax is the most significant source of revenue for the government. Most income tax is collected through deductions from employment earnings and instalments by taxpayers.

29.10 Most taxpayers who still owe tax when filing their return pay the balance promptly. However, some do not. In an effort to ensure that all taxpayers pay their fair share of income tax, Revenue Canada seeks payment of unpaid balances and of amounts deducted from employees but not turned over by employers.

Audit Scope and Objectives

29.11 Our audit reviewed the adequacy of Revenue Canada's collection policy and practices. Our objective was to see how well Revenue Canada was doing at managing its inventory of tax debts.

29.12 In addition, we examined whether Parliament was adequately kept informed on the nature and collectability of tax debt and the amounts forgiven or written off, as well as on Revenue Canada's performance in collecting debts.

29.13 We did not consider the management of accounts under dispute where legislation prevents Revenue Canada from collecting on those amounts until after the dispute has been resolved. However, we did consider collection of disputed assessments that had been resolved and ruled on in favour of the Department.

29.14 The criteria used during the audit are found in Exhibit 29.1.

29.15 We conducted our audit work at Revenue Canada's head office, three regional offices and ten district offices.

29.16 We also looked at collection practices in other organizations. We interviewed collection managers in two prominent banking institutions and in two major collection agencies. We obtained information from three provincial and three federal tax authorities. We also visited a credit bureau office, spoke with a bailiff and met with officials of two companies specializing in collection systems. Because the U.S. General Accounting Office had done extensive work in the collection area at the Internal Revenue Service, we reviewed its reports and spoke to officials on the findings and observations they had raised.

29.17 The objective of our review was to obtain an understanding of the best

Income tax is the most significant source of government revenue.

Exhibit 29.1

Audit Criteria

- Collection practice should be directed at securing Crown interests on a timely basis with least cost to the government while, at the same time, providing fair and equitable treatment of taxpayers.
- Legislative provisions should be sufficient to support an effective and efficient collection regime.
- The Department should have in place an overall collection strategy with clear objectives. The strategy should drive resource allocation.
- Collections activities should be carried out with efficient systems, procedures and work methods, and staff who know what is expected of them. The Department should seek out and implement, where feasible, cost–effective innovative collection practices.
- There should be in place an appropriate framework for monitoring and evaluating the results of collection activities as well as procedures to ensure that collection actions comply with current policies and procedures.
- Parliament should be adequately kept informed of the results of collection activities and of the nature, state and general collectability of delinquent taxes, including amounts written off, forgiven or otherwise adjusted.

practices in collection operations. Our references to practices in the private sector relate to those we found to be noteworthy, recognizing that collection operations varied in each of the organizations we visited.

Observations and Recommendations

A significant amount of departmental resources are devoted to collections

The Department's collection goal, to stop or reverse the trend of growth in tax debts, has often proved to be unattainable in the last decade.

29.18 Approximately 10 percent of the Department's Taxation employees work on collection activities. Revenue Canada spends about $100 million, or 7 percent of Taxation annual expenditures, to collect income tax debts.

Since 1988–89, unpaid income taxes have risen substantially

29.19 The year–end total of unpaid income taxes rose from $4.2 billion in 1988–89 (net of amounts not immediately payable under "taxes in dispute" legislation) to $6.6 billion in 1992–93 and have remained at this level for 1993–94. According to the Department, about 17 percent, or $1.1 billion, might never be collected.

29.20 In its 1994–95 Part III of the Estimates, the Department indicated that its collection goal, to stop or reverse the trend of growth in tax debts, has often proved to be unattainable in the last decade. The Department noted that the recent recession and slow economic recovery have affected the ability of many taxpayers to settle their accounts in a timely manner.

29.21 From 1988–89 to 1992–93, the Department experienced sustained growth in the dollar value of delinquent income taxes. This increase significantly outpaced the growth in net federal income tax revenue for that period. As illustrated in Exhibit 29.2, tax debts increased by 58 percent, while net federal income tax revenue increased by only 19 percent. For 1993–94, the value of income tax debts remained relatively constant with the 1992–93 level, while net federal income tax revenue declined.

29.22 The increase in tax debts from $4.2 billion in 1988–89 to $6.6 billion in 1992–93 and 1993–94 reflects primarily the gap between the value of new delinquent accounts coming in under district office responsibility and the value of accounts that tax collectors in district offices resolve in any year. An account is resolved when payments, write–offs or other adjustments nullify the amount owing.

29.23 The size of this gap ranged from $392 million in 1988–89 to over $1 billion in 1991–92. The gap was narrowed to $449 million in 1993–94, in part because the value of new delinquent accounts referred to district offices had declined since 1991–92 (see Exhibit 29.3).

29.24 Departmental policy stresses the need to treat taxpayers with courtesy and consideration. Firm action is supported where appropriate to ensure the equitable treatment of all taxpayers. Exhibit 29.4 illustrates Revenue Canada's collection regime.

29.25 Typically, collection actions begin with computer–generated notices asking taxpayers to send in unpaid balances. After about 90 days, unpaid amounts over a certain dollar threshold are turned over to district offices for follow–up. District office collectors contact debtors to request immediate, full payment or periodic payments, depending on a taxpayer's financial circumstances.

29.26 If a taxpayer fails to pay as arranged, the Department can offset debts

against future tax refunds or other government payments and garnishee income, bank deposits and payments due to a taxpayer from third parties. The Department may also seize and sell taxpayers' assets.

Collection Statistics

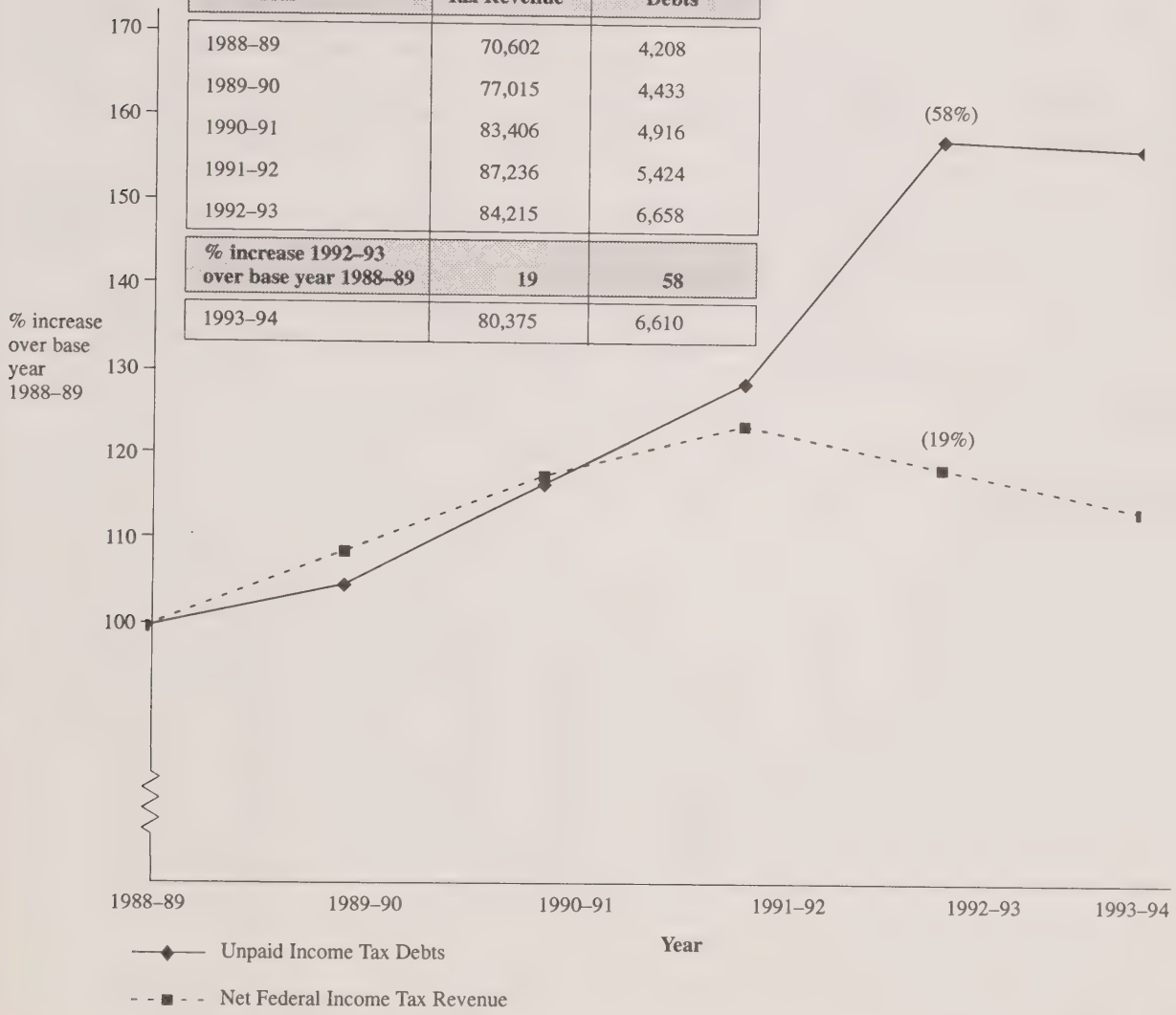
Most debts are owed by individuals, including the self–employed

29.27 We used the 31 December 1993 figures for much of our analysis in this

Exhibit 29.2

Growth in Tax Debts
($ Millions)

Year	Net Federal Income Tax Revenue	Unpaid Income Tax Debts
1988–89	70,602	4,208
1989–90	77,015	4,433
1990–91	83,406	4,916
1991–92	87,236	5,424
1992–93	84,215	6,658
% increase 1992–93 over base year 1988–89	**19**	**58**
1993–94	80,375	6,610



Source: Part III of the Estimates, Public Accounts and departmental records

At the end of December 1993, 1.6 million taxpayers had unpaid income tax debts amounting to $6.5 billion.

audit because the 1993–94 figures were still being finalized. At the end of December 1993, 1.6 million taxpayers had unpaid income tax debts amounting to $6.5 billion (net of $2.7 billion of assessments not immediately payable under "taxes in dispute" legislation). About 29,000 taxpayers had amounts in dispute.

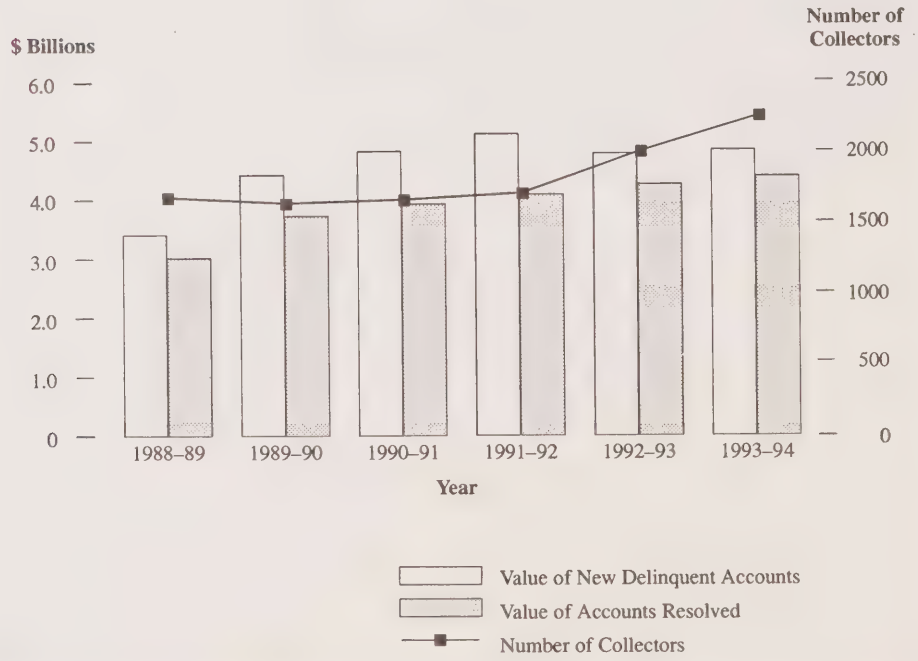
29.28 Exhibit 29.5 illustrates the distribution of income tax debts among taxpayer groups. The majority of debts belonged to individuals, including the self–employed, followed by corporations and then employers (for deductions from salaries and wages). The largest amounts of tax debt were found in the provinces of Ontario, British Columbia, Quebec and Alberta.

29.29 Many of those with tax owing were repeat debtors. Over half of the accounts under district office responsibility had income tax owing on more than one assessment. Tax collectors were busiest trying to collect from salaried employees and businesses in the professional services, construction and manufacturing sectors.

29.30 Of the 1.6 million taxpayers who owed income tax at the end of calendar year 1993, 25 percent owed roughly $5.4 billion, 82 percent of the tax outstanding. These accounts were being followed up by tax collectors in district offices and are referred to as accounts under district office responsibility. Fifty–four percent of tax debtors had minor balances outstanding and accounted for only $250 million of total income tax debt. Minor balances are subjected to different collection procedures, primarily computer–generated reminder notices. The rest of the debtor accounts (21 percent), valued at $900 million, were in arrears for less than 90 days from date of notice of assessment. Taxpayers in this category receive up to three computer–generated collection letters asking that unpaid tax be remitted

Exhibit 29.3

Changes in District Office Workloads and Resource Levels



Source: Part III of the Estimates (1988–89 to 1994-95) and departmental records.

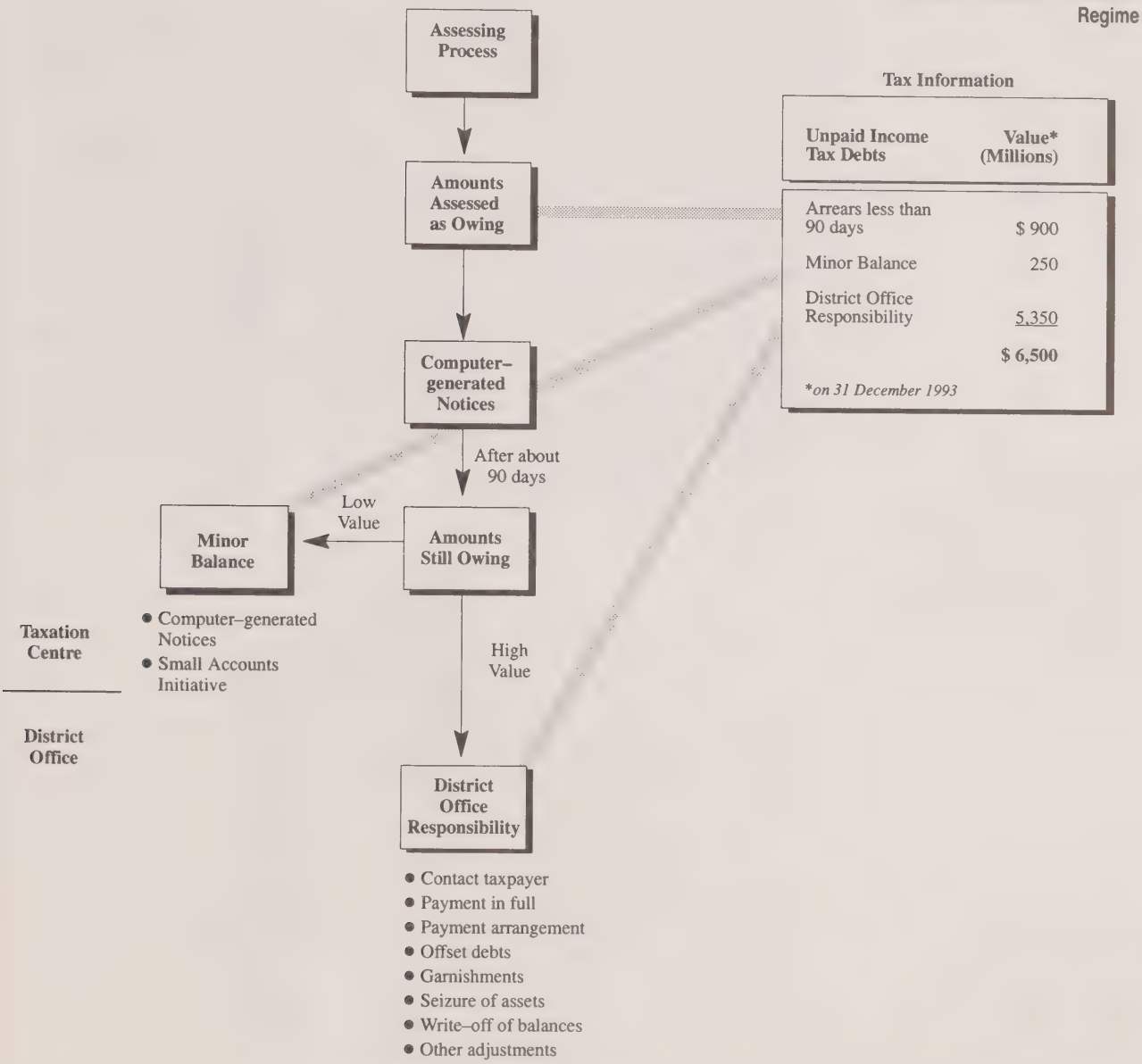
promptly. Some may be warned of possible legal action should payment not be made.

29.31 The average age of all income tax debts was 13 months. For those under district office responsibility, the average age was 18 months, although some were as old as nine years. About 31 percent of the $6.5 billion owed had been outstanding for two years or more.

29.32 A portion of these older accounts pertained to amounts recoverable under the former Scientific Research Tax Credit Program. The Department considers these amounts largely uncollectable. Total debts relating to the Scientific Research

Exhibit 29.4

Revenue Canada's Collection Regime



Tax Credit Program accounted for about 10 percent of the $6.5 billion owed. Because of the age of accounts overall, at least $1.6 billion consisted of interest and penalty charges. Departmental systems are not set up to isolate interest and penalty charges for some categories of income tax debts.

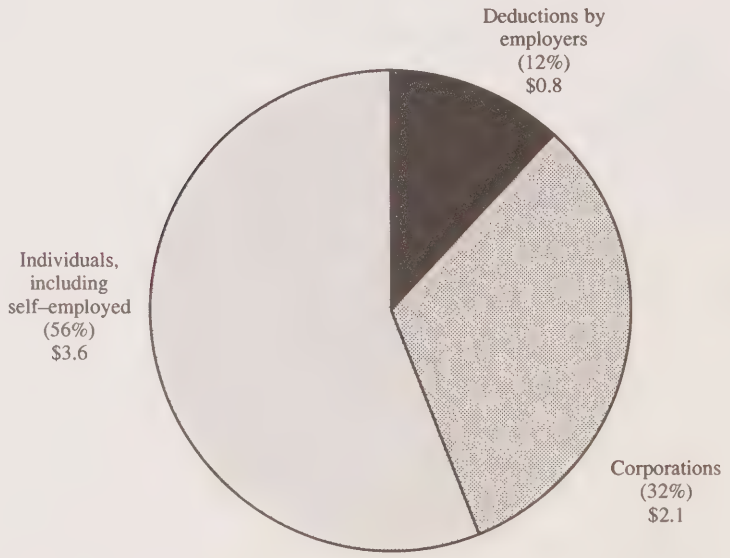
Older debts are harder to collect

29.33 Generally, the ability to collect a debt declines as its age increases. We found that the vast majority of accounts resolved by tax collectors in 1993–94 were under district office responsibility for less than one year. For accounts under one year old, payments make up to 95 cents of each dollar resolved as compared to the 80–cent overall average achieved (see paragraph 29.39). As illustrated in Exhibit 29.6, the drop in collectability is very noticeable after each one–year interval. In the first year of delinquency alone, there is an 8–cent drop in recoverability. Only 20 percent of accounts resolved by tax collectors were under district office responsibility for more than one year.

29.34 A recent study has shown that the odds of collecting delinquent commercial debts decrease dramatically with the length of delinquency. After two months, the chances of collecting late payments drop to less than 75 percent, and the odds after one year are not much better than 25 percent. These collectability patterns occur even though the private sector screens customers before granting credit privileges, as a means of containing financial risks. Under our self–assessment system, Revenue Canada cannot do this. The result is that Revenue Canada may have to deal with debtors who present greater financial risk than those in the private sector. It may be difficult to collect on amounts owing from the start, and payments on debt may not be easily forthcoming. Moreover, recoverability potential can deteriorate quickly with age of delinquency. As already noted, 31 percent of the dollar value of Revenue Canada's total outstanding receivables are

Exhibit 29.5

Distribution of Income Tax Debts among Taxpayer Groups ($ Billions)



Total Unpaid Debts: $6.5 Billion

Source: Analysis of departmental data base of income tax debts at the end of calendar year 1993.

two years of age or older from the date of initial assessment.

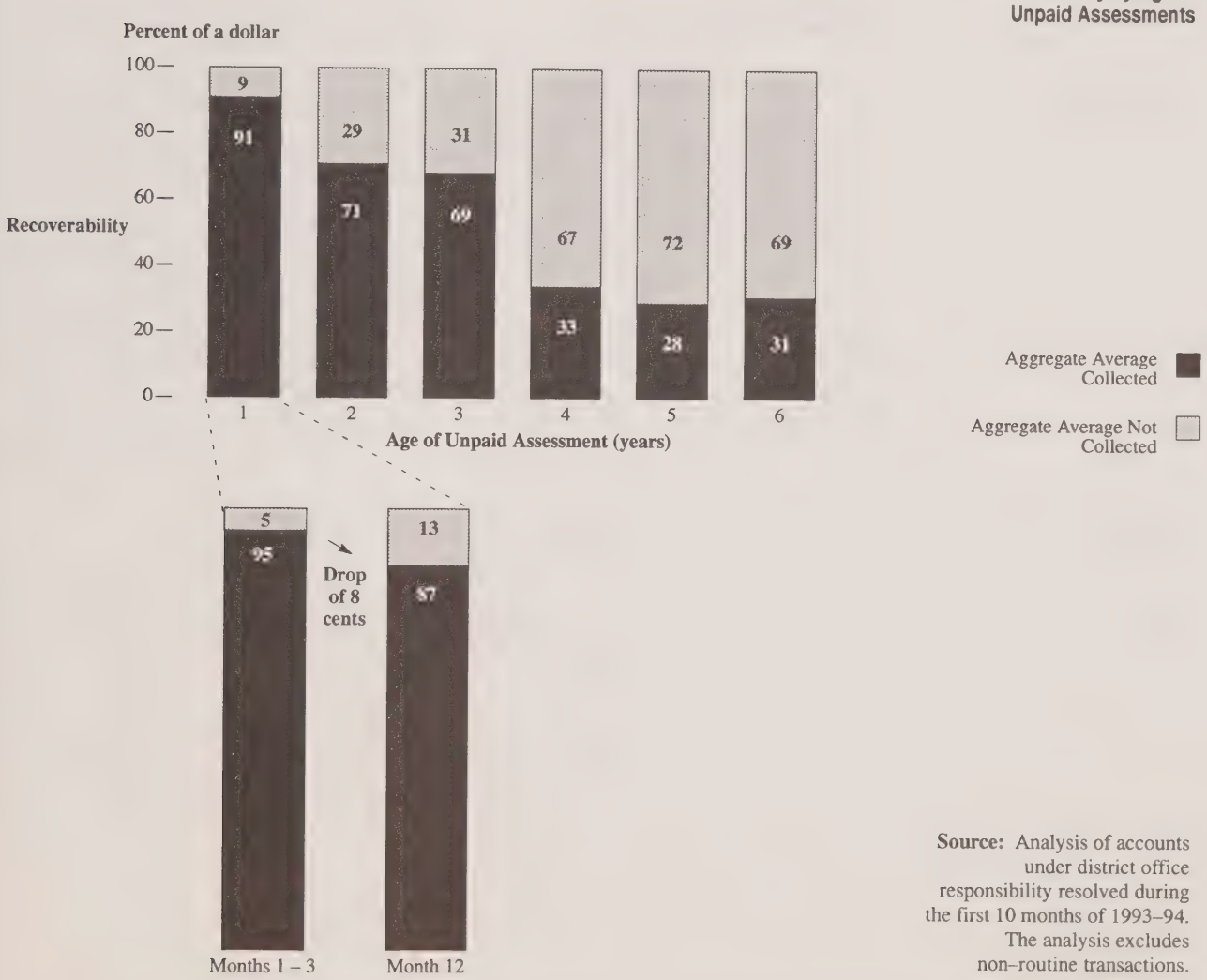
Resources devoted to collections have increased

29.35 In 1985–86, Collections received 320 additional staff to assist temporarily in all aspects of collection, including working on existing inventories that had escalated in prior years. One outcome was that $1.4 billion of accounts were written off in 1988–89 and 1989–90. In 1992–93 and 1993–94, in an effort to curtail the rising inventory of tax debts, the Department again increased its number of collectors, but this occurred some two years after the peak in annual intake of accounts referred to district offices. In the private sector, collection organizations react quickly in gearing up resources to meet changes in workload and minimize financial losses. Exhibit 29.3 shows changes in district office workloads and resource levels for the period 1988–89 to 1993–94.

29.36 New staff now account for about 24 percent of the 1993–94 Collections

Exhibit 29.6

Recoverability by Age of Unpaid Assessments



Source: Analysis of accounts under district office responsibility resolved during the first 10 months of 1993–94. The analysis excludes non–routine transactions.

resources. Productivity, as measured by total dollars resolved per collector, declined from $2 million in 1991–92 to $1.7 million in 1992–93 and is expected to decline further to $1.5 million for 1993–94. The Department explains the decline in 1993–94 in part by the fact that more effort is being directed at resolving older accounts, which is a longer and more costly process. The Department also notes that as the number of collectors increases, dollars resolved per collector could diminish because additional resources may be directed at working accounts of a lesser value.

The ratio of cash collected to value of accounts resolved has declined

29.37 For accounts under district office responsibility, the ratio of cash payments collected to value of accounts resolved has fluctuated over the past several years. Recently, it has decreased, dropping from 84 cents on the dollar in 1990–91 and 1991–92 to 79 cents in 1992–93. One factor affecting this statistic is the level of income tax debt written off in a given year. At current collection levels, for each one–cent drop in average cash recovery, there is a reduction of about $34 million in revenue. The Department forecasts that this ratio will increase to 81 cents in 1993–94.

29.38 This statistic does not measure the portion of resolved accounts that is actually settled for cash, although it should approximate that portion. We wanted to obtain a more precise estimate. Accordingly, we analyzed accounts that were resolved by collectors during the first 10 months of 1993–94. We excluded accounts pertaining to non–routine situations such as personal bankruptcies, non–residents, trusts and other sundry accounts. The information is presented in Exhibit 29.7.

The Department collected on average 80 cents for each dollar of income tax debt resolved

29.39 Our analysis revealed that, in the aggregate, taxpayers who fell into arrears had their initial assessments adjusted by 19 cents. Such adjustments would arise, for instance, when taxpayers supplied additional information or when the Department made errors in processing returns. When considering the adjusted tax debts, taxpayers paid 80 cents on each dollar of income tax debt resolved. The Department wrote off about 13 cents and

Exhibit 29.7

Analysis of Accounts Resolved

The Department collected on average 80 cents for each dollar of income tax debt resolved



Source: Analysis of accounts under district office responsibility resolved during the first 10 months of 1993–94. The analysis excludes non–routine transactions.

credited the accounts by a further 7 cents for interest and penalty reversals and other adjustments.

For Revenue Canada, an increase of one cent per dollar in cash recovery is significant

29.40 About $3.4 billion is collected annually on accounts under district office responsibility. A one–cent increase in average dollar recovery, at the current collection volume, would result in an additional cash injection of $34 million annually.

29.41 As elaborated on in paragraphs 29.49 to 29.91, our overall observation is that the Department needs to improve its operational and performance information to help ensure that collectors are working accounts in a timely and productive way.

29.42 Collection could be more timely or approached differently, especially for accounts with a higher risk of default. Enhancements to information systems, strengthening of standards of performance at the collector level and improved monitoring of results should result in improved recoveries.

29.43 The following paragraphs identify factors that we feel have hindered Revenue Canada's efforts to contain the growth in receivables in recent years and recover amounts promptly. In our view, enhancements to certain areas of collection operations could generate millions of dollars of additional revenue and possibly lower the cost of collections.

Collection Regime

The Department is making changes to improve collection operations

29.44 We wish to acknowledge the Department's continuing efforts to modernize collection support systems and improve collection operations overall. Recently, the Department has embarked on a number of initiatives to facilitate the collection effort. A notable example is the single business identifier number for all accounts within Taxation, Customs and Excise (to be expanded later to include the rest of government). Having a single business identifier number will facilitate offset of tax refunds or credits within the Department and payments from other government departments.

29.45 Another initiative is the integration of all of Revenue Canada's collection systems, beginning with Excise accounts and later including Customs accounts. The Department intends to have the same collector following up on unpaid assessments for the various kinds of taxes owed by a given taxpayer. As well, as discussed in paragraphs 29.47 and 29.48, it has recently developed new on–line management information systems to better manage collection performance.

29.46 A further action taken by the Department in the last few years concerns its minor balance accounts. These are smaller accounts receivable that would not normally be referred to district offices for collection action. Students were hired to contact taxpayers and expedite the payment of these accounts. The exercise has proved successful. The Department estimates that it received payments of $22 million in 1992–93 at a cost of

$3 million. Approximately 70,000 taxpayers were contacted by phone. In 1993–94, preliminary reports indicated that payments promised by taxpayers totalled $57 million following such contacts. The Department is continuing with this initiative in 1994–95.

Despite improvements to Revenue Canada's collection operations over the years, key deficiencies remain

29.47 We found that Revenue Canada has not kept pace with private sector practices in key areas of collection operations. Until recently, weaknesses in the Department's information systems hampered its ability to generate performance information, to enhance operational efficiency and to assess whether current collection procedures and practices are effective in achieving desired results. Exhibit 29.8 summarizes private sector collection practices that we found to be noteworthy.

29.48 As indicated, the Department has made some important improvements in the systems area. For instance, the last five years have seen the Department move away from manual, card–driven systems to on–line information systems for most accounts. On–line systems provide collectors with immediate access to information on taxpayers' balances outstanding, as well as details on their collection histories. Supervisors access this information to monitor the work of collectors by reading diary entries, and to authorize certain collection activities on a case–by–case basis.

29.49 New systems provide performance information for management and can generate ad hoc reports in ways not feasible previously. Currently, these systems provide global results, such as dollars resolved and dollars collected down to the district office level, as well as general information on the nature of the tax debt inventory.

29.50 Not all information on income tax debts is managed electronically, however. The Department maintains a separate accounting system for non–routine accounts, such as those held

Exhibit 29.8

Noteworthy Private Sector Collection Practices

Two organizations that we looked at in our audit were large companies whose survival depends on a well-performing collection operation. We noted how they used clearly stated objectives, standards and performance measures, automation, risk and debtor profiles, and specialization to generate efficiency gains.

Targets were set for expected collections and allowable delinquency rates for the whole organization. These same measures were used at the working level to determine the contribution by collectors to these targets and by divisions within the organization.

There were standards for the effort each collector should contribute to clearing accounts. The standards in place at the collector and manager levels permitted results to be monitored through performance reports. This, in turn, contributed to the efficiency of collection activities and to the achievement of the organization's overall goals.

Key to their collection operations was the use of on-line computer systems that prompted collectors to work on those accounts where risk and expected payback was greatest. Collection actions taken on each account were easily and efficiently recorded, using a set of standard activity codes to enter information into the debtor's account. This allowed the organization to assess the performance of each collector and of work groups.

Also important was the fact that operations were organized so that collectors, with the support of legal specialists and clerical staff, could focus solely on dealing with debtors.

up in bankruptcy proceedings. Approximately $1.4 billion in taxpayer receivables is maintained in this system. Over $200 million pertains to accounts having reasonable payback potential. The system generates collection cards as required for follow–up of delinquent accounts. Collectors monitor the status of an account via access to the accounting system, but most other activity is paper–driven.

29.51 Also, the separate system is not connected to the mainstream collection system. Individuals or corporations may have accounts outstanding in either or both systems, with possibly two or more collection officers handling different aspects of a taxpayer's case. There is no automatic mechanism to determine the overall net balance outstanding. Collectors must manually search for multiple balances across systems, but not all do so. The process is cumbersome and unnecessarily raises the risk of loss due to the possibility of untimely, inconsistent or absent collection action.

29.52 In a May 1994 report, the Department recognized the need to connect the separate system for non–routine income tax debts with the main system. However, the priority for this project and its expected implementation has not been established.

Automatic risk scoring of delinquent accounts is ineffective

29.53 We noted other systems weaknesses. One significant weakness pertains to the Department's automatic risk scoring of accounts.

29.54 In the private sector, risk scoring helps ensure that collectors focus attention where risk and potential payback are greatest. Generally, accounts are assessed for particular characteristics that signal risk of non–collectability. An overall risk score is obtained by combining a variety of these characteristics. Risk scoring can also be used to alter collection procedures. For example, high–risk accounts could receive aggressive collection action whereas for accounts that are likely to be paid a more moderate approach could be used.

29.55 Revenue Canada also has a risk–scoring system that is meant to help prioritize accounts for collection action. Risk scores are assigned to accounts based on the size of the balance owing and the age of the account. However, the established size ranges are few in number and very wide, and the data on ageing are not accurate. Other factors are considered as well, but these generally do not weigh heavily in the risk–scoring system. The automatic system does not take into account such important factors as a taxpayer's history (except for unremitted payroll tax) and whether the debt arose from the Department's enforcement initiatives, such as audits or special investigations. The risk score is automatically updated as an account becomes older, but is not updated for other changes, such as increases in the balance.

In the private sector, risk scoring helps ensure that collectors focus attention where risk and potential payback are greatest.

29.56 Supervisors can increase the risk score when they believe the automatic score is too low. However, from our review of sample cases and discussions in the field, this is rarely done. Interviews with Collections staff in 10 district offices revealed that they do not rely on the risk scores for prioritizing workload, but instead determine collection priority on a case–by–case basis, using their own judgment. The Department has not evaluated the effectiveness of its risk–scoring system in predicting risk and collection outcomes since the system was first implemented in 1987–88.

Any characteristic whose presence alerts collectors to the existence of high risk is a candidate for inclusion in a debtor profile.

The Department does not have profiles of tax debtors

29.57 Private sector companies alter their basic collection strategies in order to improve recoveries from debtors who pose a high risk of non–payment. Increasingly, they are using debtor profiles to customize their collection procedures and supplement their risk–scoring systems. The characteristics of certain categories of debtors that identify them as high–risk are brought to light through the development of debtor profiles, and collection strategies can then be devised to respond to various risks. Systems are put in place to monitor the results of collection strategies, and changes to collection approach, debtor characteristics or other actions are taken as required.

29.58 Any characteristic whose presence alerts collectors to the existence of high risk is a candidate for inclusion in a debtor profile. Revenue Canada has information on the age of delinquent accounts, the types of tax they represent (corporate, personal, payroll) and the industries in which debtors operate, but it has not used this or other information to construct debtor profiles.

29.59 We believe profiles should be developed for at least the following three categories of debtor accounts.

29.60 Some debts represent taxes, interest and penalties arising from assessments or reassessments pursuant to special investigations for tax evasion, and from other enforcement actions, such as audits. In these cases, the circumstances in which the debts arise may be a source of irritation to taxpayers and may lead to an attitude of resentment toward paying the amounts due. This, in turn, may prompt the taxpayer to place assets outside the Department's reach in order to avoid payment.

29.61 A second, potentially high–risk category of accounts involves assessments that have been appealed by the taxpayer and upheld in favour of the Department. Again, there may be an element of resentment that prompts the taxpayer to shield assets from Revenue Canada. Moreover, the fact that the Department cannot generally take collection action while an account is under appeal means that several months or years will have elapsed since the assessment was originally raised. As noted earlier, recoverability of a debt suffers as its age increases.

29.62 Taxpayers who have multiple assessments outstanding represent another potentially high–risk group. It may be more difficult to collect from this group than from one–time debtors because the debt is usually larger and older. A consistent pattern of failure to pay may also indicate an unwillingness to pay even if the taxpayer possesses the means to do so. As noted in paragraph 29.29, our analysis revealed a high incidence of repeat debtors. We also noted that current–year instalment payments were often being applied to cover arrears balances. This may indicate a strategy by some taxpayers to perpetually defer payment of tax by at least one year and to use unpaid tax as a source of financing.

29.63 These three examples suggest categories of taxpayer about which the Department should gather more information. An analysis of collection experience relating to these debtors would enable the Department to determine whether they represent high risk of non–payment and whether it is possible to tailor collection strategies to deal with them more effectively and to monitor results accordingly. The Department could also use the information to determine whether there is a need for

changes in administrative procedures or legislation. Revenue Canada should consider developing profiles of other categories of taxpayer as well.

29.64 The Department should establish an appropriate system for risk scoring of delinquent debts, develop debtor profiles and customize collection procedures as required.

Department's response: *The Department supports the recommendation and is continuing its efforts to research risk factors and enhance debtor profiling. It should be noted, however, that the Department has reviewed private sector practices in "risk profiling". Certain of these practices have been found inapplicable to a public sector institution, such as Revenue Canada. The Department does not have the same opportunities as the private sector for "risk profiling". In the private sector "risk profiling" begins through the use of a credit application before a client is granted a loan or a credit line, whereas Revenue Canada must accept as accounts receivable all those who owe tax.*

The Department does not fast–track collection of all large tax debts

29.65 We noted in other tax administrations, in Canada and abroad, that the dollar value of a receivable was considered an important factor in prioritizing an account for collection action. This is consistent with private sector practice. The higher the dollar value owing, the more important it is to collect an account.

29.66 The Department maintains that it gives a high priority to large accounts within the legislative framework available to it. For most categories of debt, legislation prevents the Department from forcing payment prior to 90 days from the time a notice of assessment is issued. Two exceptions are unremitted payroll taxes and debts of large corporations (defined as those corporations required to pay taxes under Part 1.3 of the *Income Tax Act*). In these cases, the Department has the legal authority to demand full or partial payment immediately upon assessment and undertakes collection of those amounts promptly.

29.67 For all other debts, regardless of the dollar value of the assessment, Revenue Canada waits until the 90–day prescribed period has expired to commence active follow–up by tax collectors to recover amounts owing. However, departmental systems are designed to automatically signal any new high–value debt to collection supervisors so that a review for risk of loss can be performed.

29.68 Legislation permits Revenue Canada to enforce payment immediately only when danger of loss can be established. Legal action can begin once the Department has satisfied a judge that there are reasonable grounds to believe that a delay would jeopardize the ultimate collection of an amount. However, officials from both Revenue Canada and the Department of Justice have indicated that it is often difficult to obtain proof that would be sufficient to convince a judge that Crown assets are in jeopardy because of a delay in collection.

29.69 During our audit we selected 40 cases to review the system for automatic signalling of large debts. We found that the system operated in most cases. However, some non–routine transactions, such as for estates and non–residents, were not referred for early assessment of danger of loss.

29.70 According to Revenue Canada officials, collection supervisors use their judgment to handle reviews of potential danger–of–loss circumstances. Some collectors may contact the taxpayer,

whereas others may not. Where no danger of loss is suspected, collectors suspend further follow–up action on the account until after the 90–day waiting period has expired, subjecting the account to computer–generated reminder notices in the intervening period.

At the end of December 1993, about 470 accounts over $100,000, valued at $350 million, were in collection–letter status.

29.71 Early telephone contact with debtors increases the chance of recovery. While written notices are important, they are less effective at obtaining payment than telephone calls. Making contact up front on high–dollar amounts would provide Revenue Canada with an opportunity to negotiate payment arrangements where required, speed up recovery of the debt and facilitate its assessment of danger of loss.

29.72 Departmental officials have stated that contacting all accounts over a certain dollar amount immediately after assessment would take up time that collectors could otherwise use to address their current account inventories. They also feel that following such a practice would mean not treating all taxpayers by the same rules. In our view, prompt collection on large accounts does not constitute inequitable treatment of certain taxpayers. Moreover, there are already differences in the way the tax system treats taxpayers. Consider salaried employees who have much less chance to become delinquent because their employers are withholding a portion of their earnings to cover taxes owed. In addition, the Department already requires reviews of large assessments for potential danger of loss. In our view, supplementing these procedures with a requirement to contact taxpayers and begin collection action would not be unfair and would not create an excessive burden on tax collectors.

29.73 We were interested in knowing the effectiveness of legislative jeopardy provisions available to collectors for corporate and personal debts that are deemed to present a danger of loss to the Crown. To this end, we requested information on the number of danger–of–loss cases that were referred over the last few years to legal counsel by collectors, the number that were presented to the courts and the Department's rate of success in obtaining favourable judgments for such cases. We found that the Department had not kept records of these actions or related judgments. We are therefore unable to comment on the effectiveness and use of this legislative provision.

29.74 At the end of December 1993, about 470 accounts over $100,000, valued in total at $350 million, were in collection–letter status at Revenue Canada, which means that, with the exception of danger–of–loss reviews, no collector action was required.

29.75 The Department should introduce procedures for collecting on all large debts soon after they become due. The Department should monitor the number of danger–of–loss cases referred to legal counsel by collectors, the number presented to courts and the extent to which favourable judgments are granted and should assess the extent to which legislative provisions are sufficient to shelter the Crown from potential loss.

Department's response: *The Department will monitor large debtors for danger–of–loss and test the effectiveness of contacting taxpayers for voluntary payment prior to the date on which enforced collection action may begin. The Department will also monitor the number of danger–of–loss cases referred to legal counsel and the courts.*

Collectors' practices for assessing taxpayer ability to pay vary

29.76 Collectors must judge the ability of debtors to pay the tax owing and choose appropriate collection action. Those who can pay should pay promptly. Allowing some taxpayers to avoid paying tax is unfair to those who do pay. The Department's policy states that taxpayers should be encouraged to make a reasonable effort to borrow the funds required to discharge their tax liability. It also elaborates on factors that should be considered in reviewing a taxpayer's income and expenses when assessing the ability to pay.

29.77 Discussions with collectors in the field revealed that they have a great deal of discretion in determining the ability to pay. While the Department has some forms that can be used to assist collectors in making these judgments, there is no requirement to adhere to a standard approach for making and documenting these assessments. As well, other than poverty thresholds, there are no benchmarks to help collectors reasonably and fairly measure ability to pay for all taxpayer groups. Benchmarks could include indicators such as tolerable debt–equity ratios for various groups of taxpayers.

29.78 We noted that one tax administration had devised detailed standards and procedures aimed at ensuring fair, consistent and documented assessment of taxpayers' financial circumstances. The organization also provided training for collectors on how to make appropriate collection decisions. At Revenue Canada, collectors are given approximately two days of training to develop necessary skills for assessing taxpayers' ability to pay. The Department indicated that it also provides a considerable amount of on–the–job training in the area.

29.79 During our audit, we observed inconsistent practices among collectors and across district offices in judging a taxpayer's ability to pay. In our review of 127 active accounts, we found that 9 percent contained no information pertaining to a taxpayer's financial circumstances. We were unable to assess the extent to which taxpayer–supplied information on assets and liabilities was verified with outside sources, since not all actions taken by collectors were documented. Practices for recording and verifying basic debtor information were inconsistent. In 18 percent of the cases, updates of taxpayer information had not been done for over a year. In two private sector collection organizations we interviewed, information was updated every three to six months.

29.80 The Department should establish clear standards for assessing, documenting and verifying information pertaining to debtors' ability to pay, together with expected time frames for making and updating such assessments. The Department should monitor collectors' adherence to such standards.

Department's response: *The Department has in place standards for assessing, documenting and verifying information pertaining to a taxpayer's ability to pay. In light of the Auditor General's observation these will be reviewed, particularly with respect to currency.*

The Department will monitor collectors' adherence to standards.

Standards relating to quality of work at the collector level need to be strengthened

29.81 During our audit, we observed variations in the approaches taken by collectors to resolve outstanding debts.

Generally, collectors approach each debt on a case–by–case basis, working within the spirit of the Department's collection policy. This policy states that debts should be retired in the shortest possible period of time consistent with a taxpayer's financial circumstance. The policy also provides general guidance on subjects such as initial taxpayer contact, payment arrangements to retire tax debts, garnishments of income sources, liens and seizure of taxpayer property.

29.82 As part of our work, we reviewed 127 active accounts for the nature of collection action taken. In 85 of the accounts, collectors used payment arrangements as a principal means for obtaining payment on delinquent debts. In 60 of these cases, or roughly 71 percent of the time, we found that taxpayers failed to make payments as promised, and the collector either renegotiated an arrangement or proceeded with legal action, such as garnisheeing wages, to collect on accounts outstanding. The practices seemed to vary, however. Some collectors were more aggressive than others in their approach. Although payments were still being received on most of those accounts, they were usually for considerably less than what had been negotiated, and tax balances remained unpaid at the time of our audit.

29.83 Out of the 60 cases in which taxpayers had broken their promises to pay, we observed several cases in which collection practices ought to be reviewed. For instance, in some of those cases, we found that the collector had not taken legal action despite the incidence of broken arrangements and poor record of collection. We noted that the cumulative period for arrangements could be quite long, extending well beyond a year. In a few of the cases reviewed, we found questionable lags in contact with the taxpayer of up to 30 months. Furthermore, we found some cases where information suggested that taxpayers were settling accounts with other creditors, while little or no payments were being made on their income tax debt. Where garnishments were attempted, most often they involved bank accounts and wages, and rarely was garnisheeing attempted on receivables, such as trade or amounts due from credit card transactions or other taxpayer assets or investments. We noted that collectors seldom gathered details of registered retirement savings plans for potential garnishment.

29.84 These examples point to a need for greater monitoring of collector activity as well as clearer standards of performance at the collector level. Our analysis (see paragraph 29.33) shows that recoverability suffers with time delays. Broken promises by taxpayers to pay their debt as arranged without compensating legal action, lags in collector follow–up of accounts, and other questionable collection actions contribute to delays in resolving accounts, unnecessarily raise the risk of financial loss and can lead to unfair treatment of taxpayers.

29.85 The Department should clearly define standards of performance at the collector level and institute procedures to monitor collectors' adherence to such standards. Performance standards would include such things as nature and frequency of debtor contacts, time frames for resolving accounts, and use of legal action and other methods to collect amounts outstanding.

Department's response: *The Department has established guidelines, in its operational manuals, that define collectors' standards of performance. The Department's initial and on–the–job training reinforce expected levels of performance. These standards will be reviewed to ensure that they clearly define*

expectations. The Department will monitor performance against these standards.

There is insufficient results–oriented information to properly assess collection performance

29.86 The Department sets goals, and district office directors monitor progress toward achievement of these goals, for the total dollar value of accounts resolved by cash payments received or write–offs in their districts. In district offices, collectors are organized into teams. However, information on the dollar value of accounts resolved by teams or by individual collectors is not available. Consequently, the Department is able to monitor only the average dollar value of accounts resolved per full–time equivalent at the district office, regional office and national levels. Because it is an average, this amount is not useful for evaluating individual or team performance.

29.87 In our view, if used prudently, it is reasonable to monitor individual and team performance on the separate basis of actual cash payments collected and amounts written off. This separation would enable the Department to provide an incentive for collectors to resolve accounts through cash payment rather than write–off. Private sector firms use actual cash payments collected by individual collectors as their primary measure of success. In the federal government, it would be necessary to combine this measure with other criteria that emphasize courtesy and fair treatment of taxpayers by collectors.

29.88 Although the Department's information systems at present are unable to provide summarized information on the dollar value of accounts resolved by individual collectors, it has plans to modify its systems to make this available on a team–level basis. Meanwhile, its systems do facilitate some monitoring at an individual level. Supervisors are able to review resolved and active accounts by reference to collectors' computerized account diaries.

29.89 Account diaries can be very lengthy and difficult to read. Because of this, private sector firms have developed systems that provide summarized, timely information on collection actions taken and results received for individual collectors and for teams. Revenue Canada's systems are able to generate volume statistics on the nature and frequency of some collection actions, but even for these they are not set up to capture results.

29.90 In addition to these deficiencies in results–oriented information, there are also deficiencies in the Department's systems for monitoring its use of collectors' time. The Department's time–reporting system does not provide adequate information on time spent by collectors on both cash–generating and non–cash–generating activities, such as preparing cases for Fairness Package consideration (new duty for collectors) or write–off, locating debtors, searching for assets and liabilities and verifying debtor–supplied information. Analysis of collectors' daily work routines could identify opportunities for streamlining work or reassigning certain tasks to support staff or specialist groups. For example, other collection organizations utilize the services of credit bureaus to obtain or verify information related to debtors' ability to pay; they may also have skip–tracing units to locate debtors.

29.91 The Department should assess the feasibility of using standard codes as a means of identifying and aggregating collection action taken by collectors in a timely, summarized manner and

The Fairness Package provides the Department with a common–sense approach for dealing with taxpayers who are unable to pay their tax debts because of personal misfortune or circumstances beyond their control.

capturing results associated with those actions. Actual dollars collected and dollars written off should be tracked separately for individual collectors and teams and taken into account when assessing collectors' performance. The Department should monitor time spent by collectors in both cash–generating and non–cash–generating activities.

Department's response: Refinements to Revenue Canada's Statistical Tracking and Reporting System, such as production measurement at the collector team level, will enhance the identification and aggregation of collection actions taken by collectors.

The Department will be tracking actual dollars collected by collector team to assist in monitoring performance, but has no plans to do the same for amounts written off. The Department relies on its write–off review process to determine whether the quality of work resulted in the loss to the Crown.

The Department disagrees with the Auditor General's interpretation of what constitutes a non–cash–generating activity and the view that these activities should not be part of the collector's job. Collectors do such activities as: verifying taxpayer information, searching for debtors' assets and reviewing extenuating taxpayer circumstances. They are all important and essential aspects of a collector's job. Revenue Canada, therefore, sees no need for any breakout of which specific activities directly or indirectly generate cash.

Fairness Package

Use of the Fairness Package has been poorly controlled

29.92 The Fairness Package legislation was enacted in December 1991 and provides the Minister with discretionary power to waive all or a portion of interest and penalties back to taxation year 1985. The Fairness Package provides the Department with a common–sense approach for dealing with taxpayers who, because of personal misfortune or circumstances beyond their control, are unable to pay their tax debts.

29.93 We also looked at those aspects of the Department's administration of the Fairness Package provisions that have an impact on the collection of income tax debt.

29.94 In March 1992, the Department released an information circular on the "Cancellation and Waiver of Interest and Penalties". At about the same time, to complement the public guidelines, internal guidelines were also issued. These encouraged the use of fairness committees in district offices to facilitate uniformity and consistency in the decision–making process. Additional guidelines were issued to district offices in October 1993.

29.95 During our audit, we attempted to find out the value of interest and penalties forgiven since legislation for the Fairness Package was enacted, but found that Revenue Canada has neither kept records that would allow for the totalling of all adjustments nor adequately monitored the circumstances in which they were applied.

29.96 We noted instances where fairness provisions were used by the Department as a means of negotiating payments on accounts in arrears. There is an urgent need to develop policies for such practices, establish benchmarks and monitor activity across district offices to ensure the fair and equitable treatment of taxpayers. Policies should take into account the possible effect of deletion of penalties and interest on the effectiveness of the Department's enforcement initiatives and on taxpayer compliance behaviour. This is particularly important,

since waivers of interest and penalties can be significant.

29.97 Relief granted under the Fairness Package must be accounted for and published to allow for public scrutiny. The *Financial Administration Act* requires that remissions of tax and forgiveness of any debt be reported in the Public Accounts. The Department has not, to date, disclosed the amount of interest and penalties it has forgiven under this program. Subsequent to our audit, the Department informed us that it recognizes the need to take action to fulfil the requirements of the amended *Financial Administration Act* in terms of reporting summary information on Fairness Package legislation decisions.

29.98 Processing taxpayer applications for Fairness Package relief can take a long time and can impact on actual collection work, since collectors are required in many district offices to prepare the cases to either support or reject Fairness Package applications. Some district offices have indicated that the time drain on collections is significant. This takes away from the time collectors could be spending on their more primary activities, such as generating cash.

29.99 We also observed that although the provisions apply to only the interest and penalties portion of the debt, collection action often stops as soon as an application for relief is received. Practices vary among district offices, but in three of the ten we visited, the norm was that collection on the income tax portion of the debt would be suspended while a decision on fairness was pending. It can take several months for a decision to be granted, and a debtor's financial circumstances may change in that period. As noted, the age of an account increases the difficulty of collection.

29.100 In May 1994, the Department established a Headquarters Fairness Committee to review existing guidelines for the application of the fairness legislation as well as to explore changes to departmental accounting systems. At the conclusion of our audit, the Committee was still in the process of fulfilling the terms of this mandate.

29.101 The Department should develop systems for tracking requests and decisions granted under the Fairness Package provisions and monitor the circumstances in which adjustments have been applied. Policies for using the Fairness Package as a means of negotiating payment on income tax debts should be developed, and related practices and the effects on taxpayer compliance behaviour should be monitored.

Department's response: *The fairness provisions of the* Income Tax Act *provide Revenue Canada with the proper basis for exercising limited discretion in its application of federal income tax provisions. The application of such discretion will inevitably evolve over time as the result of practical experience. Consequently, the Department recognized the value of assessing its application of these provisions early on to ensure that they would be applied in a consistent manner.*

The Department has already undertaken a number of initiatives in support of the application of the fairness provisions, such as:

- *undertaking an internal audit to review the application of the fairness provisions across the country;*

- *preparing guidelines that address specific functional issues; and*

- *establishing a Headquarters Fairness Committee (as noted in the chapter) to:*
  - *consolidate existing guidelines, directives and policy statements;*
  - *explore changes to accounting systems that track transactions for individual tax, corporate tax and employers' tax deduction amounts; and*
  - *prepare issue papers on key policy matters for the consideration of senior management.*

In addition to the above, the Department supports the tracking of requests and decisions granted under the "fairness legislation". A number of initiatives, such as developing automated systems to assist in the monitoring of fairness activities, refining fairness application guidelines and distributing them to staff, and increasing the level of monitoring of fairness decisions, will be put in place to track costs and assess the consistent application of the fairness provisions. The Department will clarify its existing policy with regard to using the "fairness legislation" to facilitate payment of debts where there is a demonstrated inability to pay.

As well, action is being taken to fulfil the requirements of the amended Financial Administration Act *by reporting summary information on penalty and interest relief granted under the fairness legislation.*

Information for Parliament

The estimated realizable value of tax debts may be overstated

29.102 During our audit, we looked at the Department's Part III of the Estimates for 1988–89 to 1994–95 and related sections in the Public Accounts. Generally, we found the Department's approach to reporting on collection activities to be good. The Department used simple terms to provide parliamentarians with collection goals and objectives and some commentary on its ability to meet those goals. In addition, it provided information on the amount and collectability of receivables, as well as trend information on write–offs. However, we found some information to be incomplete and inaccurate.

29.103 At the end of March 1994, the Department had a provision for doubtful accounts of about $1.1 billion on receivables of about $6.6 billion. We found that the Department's procedures for estimating the portion realizable were deficient. The Department's methodology is focussed primarily on amounts written off in prior years, but this may not be a good guide.

29.104 We noted that the Department has not undertaken a full review of its accounts to assess them for possible write–off. Also, it does not consider the age of accounts or the likely extent of adjustments arising from remissions, Fairness Package adjustments and reassessments that reduce the taxes originally assessed as owing. Such non–cash adjustments would not be reflected in amounts written off, yet they have an impact on the realizable value of reported tax receivables. These adjustments to tax debts and write–offs are significant and tend to increase with the age of an account. Our analysis indicates that the Department's current provision for doubtful accounts could be understated by at least $400 million. This figure considers only write–offs as a function of age of unpaid assessments, current bankruptcies in receivables and amounts that the Department regards as uncollectable under the former Scientific Research Tax Credit Program. If we

consider the potential impact of non–cash adjustments, the Department's estimate of the unrealizable portion of tax debts reported could be understated by as much as $1.8 billion. This higher estimate presumes that such adjustments would take place at the time a debt is resolved. However, this would not be the case for all tax debts, since some of these adjustments may occur at various points in the debt collection process.

29.105 The Department needs to provide a better measure of the extent to which reported taxpayer receivables are likely realizable. Given the billions of dollars reported as outstanding in taxpayer receivables, Parliament and the government need to know the extent to which this national asset can be considered as a source of cash from which to finance the debt and pay for future government programs.

29.106 The Department should conduct an annual review of all of its accounts and write off amounts that are deemed uncollectable. In estimating the realizable portion of tax debts remaining in inventory, the Department should consider the age of unpaid assessments, as well as remissions and other adjustments that can reduce the balance of reported amounts outstanding.

Department's response: *Most of the Department's accounts receivable are regularly reviewed for collectability throughout the year and submitted for write–off when warranted. As well, through the Departments' review of written–off accounts, large, aged, debtor accounts are also reviewed for work quality and collectability. The Department will continue to write off those accounts that are uncollectable, on a timely basis.*

The Department agrees that factors that might reduce the actual balance of accounts receivable, such as credit reassessment, remission adjustments and other adjustments, should be assessed for calculating the realizable portion of taxes owing. A methodology will be developed to make this calculation first, then continue with the existing Allowance for Doubtful Accounts calculation, which is a projection of the value of accounts that will be uncollectable and thus written off.

Summary and Conclusion

29.107 In times of concern over deficits and debts, making sure that all individuals and businesses pay their fair share of tax is important. Improvements to Revenue Canada's ability to collect tax debts could bring about millions of dollars in additional revenue yearly.

29.108 Over the past several years, the Department's goal to stop or reverse the trend of growth in tax debts has often proved to be unattainable. The Department indicated that the recent state of the economy has contributed to the rise. In 1993–94, for the first time since 1988–89, growth in delinquent income taxes stopped. The value of delinquent income taxes remained relatively constant at the 1992–93 level. The Department has undertaken a number of initiatives to modernize collection operations. Further improvements are needed. In our view, overall collection performance could be enhanced and the cost of collections could possibly be lowered by improving results–oriented information, strengthening standards of performance at the collector level, instituting effective risk scoring and debtor profiling of accounts, fast–tracking collection of all large debts, and evaluating the effectiveness of collectors and teams in recovering cash on amounts owing.

Chapter 30

Revenue Canada

Goods and Services Tax: Audit and Special Investigations

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Revenue Canada

Goods and Services Tax: Audit and Special Investigations

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Main Points

30.1 Revenue Canada relies upon registrants to assess their own Goods and Services Tax (GST) liability, file returns and pay amounts owing on time. Self–assessment greatly facilitates administration of the GST. During the introduction of the GST, the Department's strategy emphasized registrant education and assistance to ensure compliance with the legislation. As the GST matures, the Department's strategy is shifting emphasis from education to other compliance activities.

30.2 However, because some citizens fail to obey the law, well–targeted, credible sanctions against non–compliance are necessary. Non–compliance has significant effects: it results in loss of tax revenue needed to fund government programs and to service the national debt; it places those who comply at a competitive disadvantage; it contributes to an inequitable distribution of the burden of taxation; and it undermines the integrity of the tax system. When registrants do not remit GST collected from customers, they are misappropriating funds that belong to the government and creating a breach of trust.

30.3 From 1991–92 to 1993–94, there has been continued improvement in terms of additional tax revenue assessed as a result of GST audits. During this period, more than $2.1 billion was assessed by audit.

30.4 While significant, this amount was below projections. For example, in 1993–94, it was projected that audits, excluding those conducted in the province of Quebec, would generate $1.36 billion in additional tax assessments, but the actual amount was $613 million. The variance was due, in part, to projections that may have been too optimistic, fewer resources devoted to audits than planned, and lack of effectiveness in the audits that were carried out.

30.5 We reported in 1992 and 1993 that competing priorities have affected the development and implementation of enforcement activities such as registration and collection. In this chapter, we observe the impact on audit and investigations. Enforcement is impeded by a lack of information about registrants; by the absence of reliable tools for identifying and selecting registrants for audit; and by inadequate monitoring practices. Because of these and other factors, 40 percent of all audits conducted in 1993–94 did not result in additional tax assessments or reductions in refunds or rebates.

30.6 Raising additional tax assessments is one objective of audit. Another is to demonstrate enforcement efforts in the registrant population to remind people that they might be audited. During the last three years, the number of GST audits has declined, and the number of investigations and prosecutions has been low. Furthermore, close to one half of all audits consisted of limited checks conducted in GST offices, which do not generate significant awareness of enforcement among registrants.

Introduction

30.7 When a new tax regime like the Goods and Services Tax (GST) is set up, one expects a high risk of error, fraud and abuse. Non–compliance with tax law results in loss of tax revenue needed to fund government programs and to service the national debt. It places businesses that comply at a competitive disadvantage because they pay their fair share of tax while others do not. Non–compliance also undermines the integrity of the tax system.

30.8 Accordingly, a well–targeted, credible enforcement system is needed to detect and deter error, fraud and abuse. Enforcement activities are aimed at creating and encouraging compliance and demonstrating fair and consistent treatment of all Canadians.

30.9 In our previous reports, we pointed out the daunting task and difficult choices faced by Revenue Canada in implementing the GST. Ensuring compliance is a difficult task when consumers, businesses and government officials must become familiar with new legislation in an environment that seems increasingly hostile to compliance.

30.10 Revenue Canada is responsible for assessing, collecting or refunding GST for nearly two million registrants, many of them small businesses. At first, the Department's strategy to ensure compliance gave priority to education and assistance. This strategy recognized that the better informed people are, the greater the likelihood that they will comply with their obligations. But this approach is not without risk. Enforcement activities have suffered. As the GST matures, the emphasis of the strategy is shifting from education to other compliance activities.

Audit Objectives and Scope

30.11 Our audit examined the adequacy of Revenue Canada's GST Audit and Special Investigations coverage, the results of its activities and the appropriateness of the support systems and procedures. We carried out our examination at headquarters and in seven district offices. To help the reader understand the context of our observations and recommendations, we have included in Exhibit 30.1 a description of audit and investigation functions typically applied in the administration of value–added taxes

Non–compliance with tax law results in loss of tax revenue needed to fund government programs and to service the national debt.

Exhibit 30.1

**Value-Added Tax (VAT)
Auditing and Investigating**

The first level of intervention is an **advisory visit** soon after a business or an organization registers. This visit serves two important purposes: to educate the new registrant and to gather basic information that will be useful to the tax administration in its future dealings with the registrant. The advisory visit is not an audit but is often performed by an auditor.

The second level of intervention is a **desk audit**. A desk audit is a screening process performed by an auditor that involves checking returns for accuracy and completeness. Because it does not require contact with the registrant, the registrant may not be aware of a desk audit.

The third level of intervention is a **field audit**. A field audit consists of checking specific aspects of the registrant's operations, books and records at the registrant's premises. The intent is to detect error and fraud and to establish the basis of future compliance.

The fourth level of intervention is an **investigation**. Usually, if an auditor suspects fraud, a case will be referred to a Special Investigation unit, where evidence will be gathered and analyzed to see if it is possible to prove tax evasion. Referrals may also come from registration or collection units, income tax officials or members of the public.

(VAT), of which the Canadian GST is one example.

Observations and Recommendations

Audit and Investigation Results

Audits and investigations are designed to enforce compliance with the law and, by doing so, maintain public confidence in the integrity and fairness of the tax system.

Additional tax assessments from audits are significant but less than projected

30.12 Audits and investigations are designed to enforce compliance with the law and, by doing so, maintain public confidence in the integrity and fairness of the tax system. These enforcement activities must be conducted within a strategic framework that can adapt to newly identified threats or opportunities and form the basis for operating objectives and priorities. We therefore expect that the results will be assessed to see if objectives are met and priorities respected.

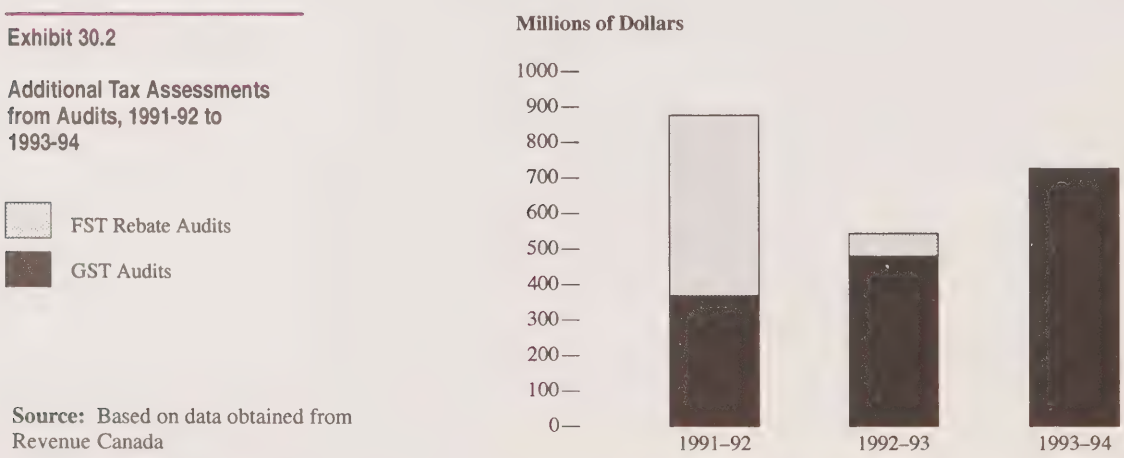
30.13 Additional tax assessments generated from audits have improved each year since the inception of the GST (see Exhibit 30.2). Revenue Canada has pursued two different audit strategies over the three–year period. In the fiscal years from 1991–92 to 1993–94, GST audits produced a total of more than $2.1 billion in additional tax assessments.

30.14 In 1991–92, the additional tax assessment from audits totalled $877 million and, as expected, was mostly attributable to reductions in Federal Sales Tax (FST) rebate claims. Having learned from the experience of New Zealand, Revenue Canada focussed on FST rebates and on GST returns where registrants were claiming refunds. New Zealand found that both rebates and refunds were subject to many fraudulent claims. FST rebates were meant to prevent double taxation by refunding FST paid on inventory held for resale. Revenue Canada wanted to ensure that legitimate, accurate FST rebates and GST refunds were processed and paid quickly and that accounts where there was suspicion of fraud or gross error were identified for audit.

30.15 In 1992, the Minister of Finance announced a series of measures directed to containing the deficit and revitalizing the economy. For Revenue Canada, this announcement translated into an enforcement strategy focussing on the generation of revenue, particularly from registrants who were not complying with filing requirements. In 1992–93, the total additional GST assessments resulting from audits amounted to $540 million, of which 25 percent came from non–filers.

Exhibit 30.2

Additional Tax Assessments from Audits, 1991-92 to 1993-94



Source: Based on data obtained from Revenue Canada

30.16 The focus remained on revenue generation in 1993–94. The total additional tax assessments from audits came to approximately $723 million, including $110 million assessed in the province of Quebec by auditors from the ministère du Revenu du Québec on behalf of the federal government. However, the additional tax assessed was not as significant as projected: there was a variance of $700 million between actual and projected assessments from audits.

30.17 The variance can be attributed to three factors. First, it seems plausible that Revenue Canada projections may have been too optimistic, given that the Department had little or no historical data to go on. We have not tried to establish the reasonableness of the projections. Second, fewer resources were devoted to audits than had been planned. This is discussed in the following paragraph. Third, audits may not have been as effective as they could have been. Subsequent sections of this chapter point out ways in which audits could be improved.

30.18 The largest GST administration function in regional and district offices is audit, which, along with investigation, accounts for almost half of the human resources allocated to this tax. Since the GST started in 1991, many auditors and investigators have been diverted from their normal activities. During 1993–94, about 370 employees were diverted to other activities. Many switched to the collection function, and the Department estimates that the revenue generated in collections offset the revenue foregone in audit. The shortfall from projected audit tax assessments resulting from this diversion is estimated at $190 million. A similar workforce diversion in 1992–93 resulted in a shortfall of $133 million. No figure is available for 1991–92.

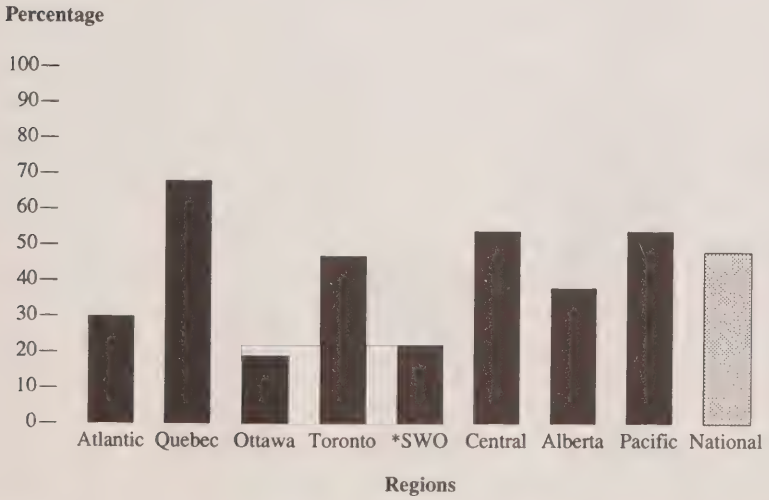
Audit coverage is low

30.19 Although it is an important objective, the success of enforcement cannot be measured solely on the basis of additional tax assessments produced. Visible enforcement efforts to detect and correct non–compliance and to encourage future compliance are equally important. Audit is a vital component of the Department's enforcement activities and overall compliance measures. Given the current expression of public concern over evasion, we expected to find an increase in this enforcement activity. However during the last three years, the number of

Although audit is a vital component of the Department's enforcement activities and overall compliance measures, during the last three years the number of audits has declined.

Exhibit 30.3

Desk Audits as a Percentage of Total Audits, 1993–94



* Southwestern Ontario

Source: Based on data obtained from Revenue Canada

audits has declined. Moreover, as illustrated in Exhibit 30.3, close to one half of all audits were desk audits. It is our belief that desk audits are less visible than field audits and generate less awareness of enforcement efforts among registrants.

30.20 Prior to the introduction of the GST, the Department developed a multi–year plan, anticipating that a mature audit program would be in place by fiscal year 1993–94. The plan was to have more frequent but shorter audits than under the FST regime and to rely on deterrence to a much greater extent. Key elements of the audit strategy were the volume of audits to be conducted and the number of audit staff required. It is important for the Department to be able to perform its audits promptly, since an assessment or reassessment of a registrant must generally be issued within four years after the day on which the taxes became payable. Assuming a population of 1,600,000 registrants, it was expected that 152,000 audits (excluding audits of FST rebates) would be performed every year by about 2,300 auditors.

30.21 Exhibit 30.4 presents the number of audits completed since the GST was introduced. The exhibit shows that after the first year, the Department failed to meet its target of 152,000 audits. In 1993–94, about 80,300 audits were completed. It should be noted that, as discussed in a subsequent section, even this number of audits is overstated due to discrepancies within the GST automated system.

30.22 Comparison with other countries provides another perspective from which to assess audit coverage in Canada. In 1992–93, the United Kingdom had 1,600,000 registrants and performed 378,000 audit visits. Granted that the type of intervention (see Exhibit 30.1) and number of auditors may differ from one country to another, this level of activity is more than four times the Canadian level.

30.23 In our 1989 Report, we expressed concern that Revenue Canada had shown record low rates of Federal Sales Tax audit

Exhibit 30.4

Completed Audits, 1991-92 to 1993-94

Revenue Canada pursued two different audit strategies over the three–year period: up to the fall of 1992, audits focussed on FST rebates and GST refund claims; subsequently, priority was given to revenue generation.



Source: Based on data obtained from Revenue Canada

coverage – less than seven percent at that time – and that there was a continuing downward trend in the ratio. In a report on income tax enforcement programs in 1990, we expressed a similar concern with the decline in income tax audits. We have the same concern this year with respect to GST audits, for which the current coverage rate is declining toward three percent.

Number of investigations and prosecutions is low

30.24 The results of GST investigation activity started to become apparent in 1993–94. During that year, 107 cases were closed after preliminary investigations, and 17 cases were closed after detailed investigations. There were 15 convictions, five of which resulted in jail terms and hefty fines. As of March 1994, the Department had 240 cases in the investigation workload, and there were 33 cases before the courts.

30.25 The number of detailed investigations and prosecutions was less than 50 percent of the planned figure. The reasons for this low level of investigation activity are threefold. First, it is very difficult to start with a strong investigation unit at the beginning of a tax regime, since most cases are obtained through complaints and referrals. It takes some time to build the necessary information and to train investigators. It may also take one to two years to complete a case. Second, while the audit function struggled to establish its own foundation during the past three years, expectations in terms of quality and number of referrals to investigations were not clear. Furthermore, the type of audit intervention performed, such as desk audits and field audits with a high focus on quick generation of revenue, reduced the potential for "good" referrals to investigations. Third, fewer resources were used in investigation activities than planned. For example in 1993–94, there were 171 employees planned for GST investigations; however, only 149 were used in this function.

Federal Sales Tax audit coverage was lower than expected

30.26 In 1989, we indicated that a strong close–out strategy and efficient deployment of audit resources would be necessary during the transition from the Federal Sales Tax (FST) to the GST. An internal review was initiated by the Department in 1992 to assess the final phase of the FST licensee audit program. Preliminary findings indicated that audit coverage was not as high as expected during the transition period, since resources were shifted to implement the GST.

Audit and Investigation Systems and Practices

30.27 Enforcement activities should be conducted efficiently, fairly and consistently. In an environment of scarce resources, where risk of fraud and error is high, sufficient and appropriate management information is crucial to the success of an enforcement program. Equally important are adequate planning, supervision and monitoring.

30.28 We found that the lack of information on which to base the selection of registrants for audit is a major impediment to district offices' ability to target enforcement actions effectively. We noted in our 1992 Report that the Department decided to limit the application for registration to a one–page form to simplify its completion, but at the same time, this reduced enforcement capability. The limitations described below concerning the recording and analysis of audit information have also

Lack of information on which to base the selection of registrants for audit is a major impediment to district offices' ability to target enforcement actions effectively.

restricted the efficiency and effectiveness of the audit function.

System discrepancies compromise accuracy and reliability of reported results

30.29 Information to manage the audit program is derived from the GST automated system. Information is captured at registration time and when registrants submit their returns and payments. Upon completion of an audit, the GST automated system is updated with selected information, including the period audited, amounts assessed, time required to complete the audit and revised registrant information. From this system, summary reports are printed monthly, showing the type, number, total audit time and revenue change for completed audits. While these summary reports are useful, they do not permit analysis of audit results by categories such as industry sectors, business size, registrant location or "no–change" audits. Therefore, ad hoc reports were developed to supplement these summary reports. However, the production of these reports has often required extensive lead time and carried risk of errors and inconsistencies.

The Standard Industrial Classification code is essential for targeting audit selection.

30.30 In September 1993, headquarters and the district offices received a copy of the audit information for 1993–94 contained in the GST automated system to analyze on stand–alone computers. This practice reduced the need for ad hoc reports. We obtained and analyzed these same data and noted discrepancies that compromise the accuracy and reliability of the reported audit results. For example, the GST automated system allows the same audit to be recorded more than once and counts corrections of the Department's own record–keeping errors as completed audits. As a result, the number of audits reported by the GST automated system is overstated.

Information to target audit selection is incomplete

30.31 All types of audit require tools or techniques that will ensure effective and consistent selection across the country. Because certain registrant information is not collected at time of registration, initiatives to develop needed information for such tools have had only modest success.

30.32 We reported in 1992 that the registration form lacked certain data needed for administration of the GST and that these data should be obtained when registrants are first contacted. A primary example is the Standard Industrial Classification (SIC) code that is assigned to registrants, describing their business sectors and main activities. The code is essential for targeting audit selection, studying compliance behaviour and measuring revenue generation in specific sectors. In 1992, about 700,000 accounts were not coded. At the end of March 1994, there were 420,000 accounts still not coded, varying from 3 percent of the registrant population in one region to 36 percent in another. Starting in February 1994, measures have been taken to ensure that a valid SIC code is entered when updating the GST automated system for audit results. However, up to that time, we observed that in 10,000 cases the SIC code information was still missing after an audit had been conducted.

30.33 The development of a system that assigns points to registrants based on criteria such as annual sales, industry and time since last audit began in the fall of 1992. A list of registrants with high scores was generated and delivered to the district offices in March 1993. The development of this point–scoring system was adversely affected by a number of factors. The analysis was based on a small sample of primarily GST refund

claims, which included a high number of desk audits. The points assigned in this system were developed on the basis of data that were incomplete due to missing returns, missing annual sales figures and missing SIC codes. The Department continued attempts to improve this selection tool, and another list of high–scoring registrants was sent to the district offices in May 1994. At the time of our audit, the extent of use and results from this new list were not known.

30.34 District offices also have access to other information sources for audit selection: selection systems developed in regions (similar to the national point–scoring system); the registrant data base created from the GST automated system; lists of non–filers; referrals from registration and special investigation units; and examination of business advertisements, title searches and business listings in the yellow pages of the telephone directories. Capturing this information on the GST automated system would permit analysis of the comparative effectiveness of these sources or methods of audit selection.

Curtailment of "compliance test audits" and "first audits" results in lost opportunity to collect valuable information

30.35 Compliance test audits are an important mechanism for obtaining information to manage the audit function. These tests involve auditing a random sample of registrants in various industry sectors. They are full–scope field audits that can help draw conclusions about the level of compliance and the revenue gap. In 1992–93, the intent was that 35 percent of audit effort would be directed toward compliance test audits; the results would be used to provide an early warning system for problem sectors and to direct further audit activity to areas of high risk and areas where audits could be expected to deter non–compliance.

30.36 Compliance test audits started as planned in 1992–93 but were abandoned six months later. The Department stated that this move was made in response to the government's concern relating to the collection of overdue taxes. Compliance test audits generated, on average, a lower immediate impact on tax assessment than did other types of audits; the switch in strategy was definitely beneficial from this point of view. Less clear, however, is the long–term effect of not collecting essential information required to improve automated verification procedures, computer–assisted audit selection techniques and the capacity for early detection of changes in compliance behaviour.

30.37 The term "first audit" refers to a visit to a new registrant in order to explain obligations, to detect businesses registered for fraudulent purposes and, generally, to detect problems early, when they can be easily corrected. Revenue Canada conducts virtually no first audits, although it originally planned to do approximately 14,000. The Department stated that first audits were abandoned because it felt that, in a period of limited resources, the resources could be more effectively used in other audit programs. Consequently, an excellent opportunity was missed to gather basic information useful for future audit, registration or collection actions—information such as details of taxable and exempt activities, annual sales, quality of accounting records and systems, related corporations, validity of elections filed and bank accounts.

Screening returns for audit takes more time than planned

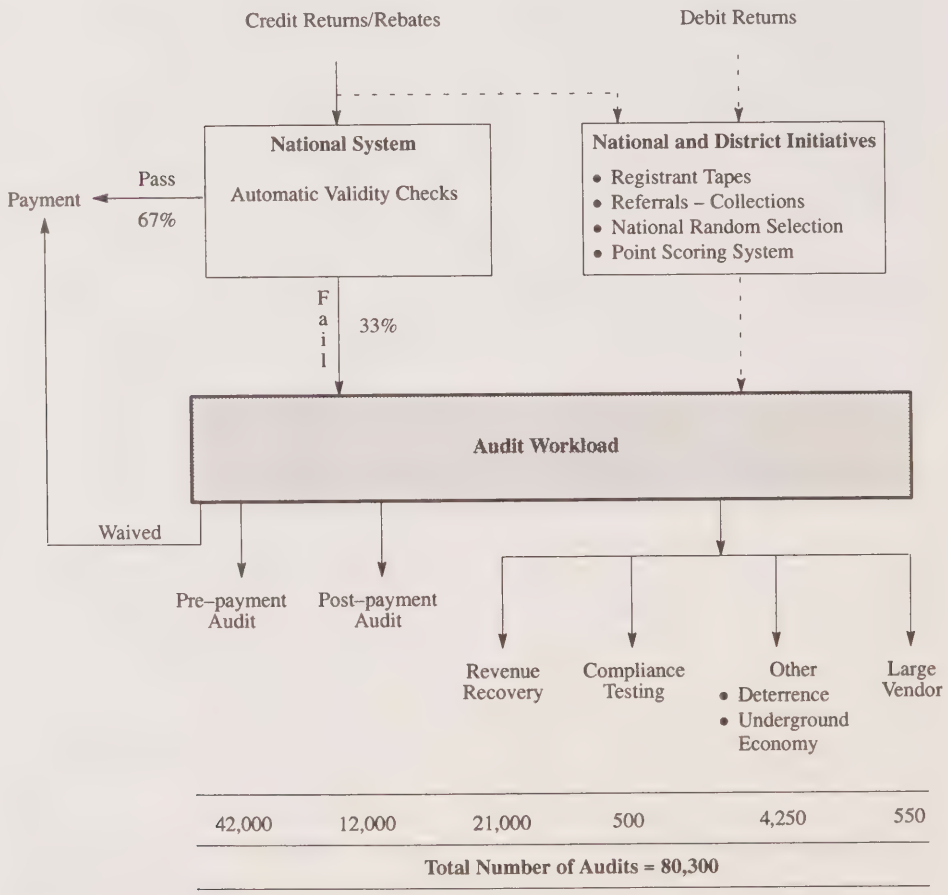
30.38 To understand how returns are selected for audit, one must begin with some facts on how returns are processed.

GST returns and rebates are processed at the Prince Edward Island and Quebec processing centres. In 1993–94, about 7.3 million GST returns and 300,000 GST rebates were received. Of the GST returns, 2.3 million claimed refunds (credit returns) and 5 million owed money (debit returns). Exhibit 30.5 shows the volume and flow of processing and auditing GST returns and rebates for 1993–94.

30.39 A prepayment audit system is in place to prevent payments of rebates and refunds to registrants where there is suspicion of fraud or gross error. The system consists of a series of automatic validity checks, including dollar thresholds for individual amounts claimed, cumulative thresholds for payments to date, separate checks for registrants who have never been audited or who are submitting their first claim, and checks for inconsistent information on returns or applications. Returns and rebates that pass the validity checks are automatically paid. In 1993–94, approximately 630,000 claims failed validity checks and entered the audit workload. We noted that little analysis had been done with respect to the usefulness of the various validity checks. Auditors are to establish thresholds tailored to individual registrants in order to prevent recurring credits from entering the audit workload. We found that registrants' individual limits had not always been placed on registrant accounts, despite the national effort to do so. In fact, even after a refund

Exhibit 30.5

Source and Selection of GST Audits, 1993–94



Source: Based on data obtained from Revenue Canada

or rebate audit, individual thresholds were not recorded by the auditor in 7,016 registrant accounts in 1993–94.

30.40 Returns that fail the validity check are reviewed through a desk review process, and those perceived as presenting a risk of gross error or fraud are selected for audit. The desk review process is very labour–intensive, involving much of the work time of audit supervisors. The Department accounts for time devoted to desk reviews under the caption of supervision, training and administration. For 1993–94, the target for this category of time usage was set at 34 percent of auditors' time, but, in fact, 47 percent of auditors' time was taken up by such activities.

Validation of complaints and referrals could be done more efficiently and effectively

30.41 During 1993–94, Special Investigations received and took action on 4,000 complaints and referrals from the public and from various internal sources in connection with suspected violations of the *Excise Tax Act*. Because of the risk and volume involved, it was important that they be dealt with efficiently and effectively.

30.42 Forty–six employees were used to validate the information and to determine whether enforcement action should be taken. Approximately 1,800 of the 4,000 cases were referred to other functional units such as Audit or Registration for further examination. The remaining 2,200 cases were discarded from further enforcement action because they lacked substance.

30.43 Having investigators perform this function reduces the time they have available to devote to actual investigations. Possible alternatives include:

- providing Audit or other functional units within the Department with training or guidelines on how to improve the quality of referrals from these units;
- freeing investigators from preliminary review tasks by allocating as much of this work as is practical to staff at lower levels.

Audit and investigation work is not being adequately monitored

30.44 Appropriate supervision and monitoring mechanisms are necessary to ensure that audit and investigation decisions are consistent. These mechanisms include file reviews after an audit, on–the–job training, management information systems and quality review of district audits and investigations. We noted that there is a need for closer supervision and monitoring of the work performed by GST auditors in each district office.

30.45 Auditors face, with increasing frequency, complex issues raised by tax specialists who are often interested in testing the application of the legislation in certain circumstances for the benefit of their company or their clients. The changes in priorities, amendments to the legislation, diversion to other functions and extensive time spent in workload management activities have made it more difficult for GST auditors to gain the experience needed to deal with complex issues. In view of this situation, audit supervisors need to be more involved in the planning and review of auditors' work and decisions and need to promote the exchange of lessons learned about the behaviour of certain sectors of the registrant population and the avoidance schemes that are in use.

30.46 Completed audits that we looked at did not show evidence of pre–audit

The desk review process is very labour–intensive, involving much of the work time of audit supervisors.

Quality assurance and monitoring by regional offices of audit and investigation work in district offices have been sporadic.

planning or post–audit review. The scope, time and tools used to conduct the same types of audits varied considerably. We also noted that quality assurance and monitoring by regional offices of audit and investigation work in district offices have been sporadic. These circumstances have contributed to variances among regions in the number of desk audits as a percentage of total audits (see Exhibit 30.3) and in the number of audits with no change in tax assessed (see Exhibit 30.6). Approximately 31,000 audits resulted in no change in tax assessed in 1993–94.

30.47 We noted that procedures followed and information captured in certain cases were not adequate and that training provided to special investigators needs to be strengthened. Investigators have not yet had extensive experience in conducting investigations; therefore, their activities and decisions need to be closely monitored. A case could be lost if the investigator does not provide sufficient evidence, although so far the Department's record in obtaining prosecutions is very good.

30.48 There is a need for stricter control, co–ordination and monitoring of audit and investigation activities, both to improve the current results and to guarantee the application of minimum standards to ensure fair treatment of registrants and consistency in enforcement decisions.

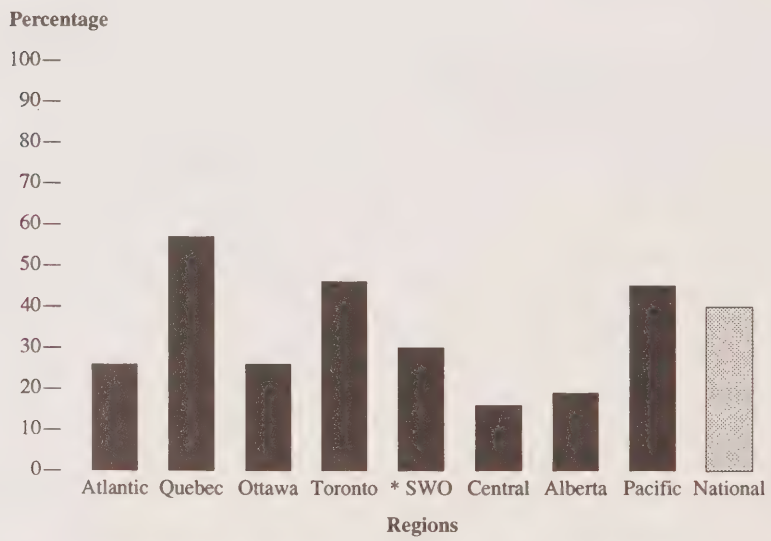
Audit Laptop System shows promising results

30.49 All GST auditors have been provided with laptop computers and have been trained to use the Audit Laptop System (ALS). ALS is a set of audit tools. It provides an extensive number of audit programs and procedures, such as the comprehensive audit program, the GST refunds audit program, procedures for rebates and procedures for audits of financial institutions. It includes audit manuals, some industry sector profiles, departmental directives and policy papers, GST legislation and memoranda, bulletins, word–processing and spreadsheet facilities.

30.50 Providing auditors with access to many sources of information helps reduce the time needed for research. In addition,

Exhibit 30.6

Percentage of Audits Resulting in No Change in Tax Assessment, 1993–94



* Southwestern Ontario

Source: Based on data obtained from Revenue Canada

the provision of predetermined audit programs and procedures assists the auditors in adhering to work standards and in carrying out their responsibilities in an orderly fashion.

Accountability and Reporting

Key performance indicators are not reported to Parliament

30.51 Audit and Special Investigations have specific roles to play in the overall compliance and enforcement strategy. The audit function is meant to verify compliance and maintain public confidence in the integrity of the tax system; the investigation function is aimed at the detection and deterrence of fraudulent activity. Given the significance of their roles, we would expect relevant, reliable and understandable information on these functions to be reported to Parliament.

30.52 As discussed earlier, comprehensive analysis of audits and investigations has been limited because of lack of information and system discrepancies. Accordingly, performance information reported in Part III of the Estimates has been limited too, presenting information on workload only. In our view, as it currently stands, the information provided on these activities could be enhanced by including:

- **a breakdown of the number of activities by type of intervention.** There are significant differences in terms of impact and resources required for desk audits versus field audits, for audits of small businesses versus those of large corporations or for preliminary investigations versus detailed investigations.

- **the utilization of human resources.** Since close to 50 percent of the GST staff are employed in Audit and Special Investigations, indicators of efficiency (such as performance in relation to the time standards per audit or the use of audit resources in indirect activities) would be relevant to report.

- **the coverage rate of the population and the impact of audits and investigations.** Information regarding the efforts and success of the Department in identifying and targeting high–risk areas and the impact of these interventions could also be reported. For example, in order to help assess the impact of audit interventions, it would be useful to disclose information on additional tax assessed, interest and penalties charged, fines and jail sentences imposed and the reduction in amounts claimed. Comparisons with targets and previous years' achievements would also be useful.

Conclusion and Recommendations

30.53 This chapter repeats a theme that appeared in our previous work on the GST: since inception of this tax, the capacity of the Department to ensure compliance has been seriously challenged. In 1992, after the introduction of the GST, we noted that the Department's capacity to identify new registrants was limited. Furthermore, we observed that enforcement activities had been curtailed due to redeployment of resources to other activities, such as providing information to registrants. While examining the status of GST collections in 1993, we discovered a high level of non–compliance: almost one in three registrants was delinquent in some fashion. We recommended that all essential aspects of the departmental collection strategy be reviewed, including the allocation of resources to this particular enforcement activity.

30.54 Because the GST was new, auditors and investigators had to go through a learning curve and adjust their practices and procedures in response to

changes in legislation and in priorities. This situation was expected, but it reduced the extent and potential impact of audit and investigation activities.

Revenue Canada must achieve a greater level of maturity and stability in enforcement activities.

30.55 Revenue Canada must deal with a registrant population larger than expected and with significant non–compliance risks. To do so, it must achieve a greater level of maturity and stability in enforcement activities. The recommendations that follow are addressed to Revenue Canada and are aimed at improving the coverage and the results of audit and investigation activities, and the practices and procedures that support these activities. These recommendations are also aimed at ensuring that, in the future, members of Parliament will be provided with relevant, reliable and understandable information to enable them to assess enforcement efforts and measure the threat of loss of tax revenue needed to finance government programs and to service the national debt.

30.56 Revenue Canada should pursue its initiatives outlined in Exhibit 30.7 in order to:

- **improve the quality and quantity of registrant information it possesses;**
- **determine objectives and implement operational plans to ensure visible enforcement efforts throughout the registrant population and to obtain greater amounts of additional tax; and**
- **develop effective audit selection techniques, in part by applying the results of experience acquired in various regional and district offices.**

In addition, Revenue Canada should:

- **review the efficiency and effectiveness of its present methods of validating complaints and referrals to Special Investigations; and,**
- **improve its reporting in Part III of the Estimates by including, at a minimum, performance information on the number of activities by level of intervention, utilization of human resources, coverage rate and impact of audits and investigations.**

Department's response: *The Department agrees with the need to improve registrant information. As indicated by Exhibit 30.7, the Department is taking significant steps to improve the quality and quantity of registrant information.*

The Department supports the need for increased audit visibility to effectively ensure good registrant compliance. As Exhibit 30.7 notes, the administrative consolidation of the Department is seen as key, in achieving improved cost–effective compliance. Harmonized audit activity is already proving effective and its effectiveness in the context of visibility and compliance will increase with an integrated approach to audits and investigations under the Customs Act, *the* Excise Tax Act, *and the* Income Tax Act.

The Department is continually refining its audit selection techniques as indicated in Exhibit 30.7 and will be taking additional steps to harness its experience in assessing the effectiveness of the audit selection system.

The Department initiated, in May 1994, a review to determine the best process to validate complaints and referrals to GST Special Investigations and also to maximize resource effectiveness. The Department is taking steps to implement the results of the review.

The Department will undertake a review of reporting in Part III of the Estimates to include the various elements noted in the recommendation.

Exhibit 30.7

Initiatives the Department Has Under Way to Improve Verification, Enforcement and Compliance Research

Initiative/ Plan	Description	Target Date
Administrative Consolidation	The Verification, Enforcement and Compliance Research Branch provides policies, programs, procedures and functional guidance and direction related to GST/Excise and Income Tax verification and enforcement. This includes the provision of client assistance related to these functions and responsibility for international verification and enforcement activities, excluding those related to Customs, and for strategies to penetrate the underground economy. Federal–provincial co-ordination is also a responsibility of this Branch. The Administrative Consolidation provides the opportunity to organize and to achieve directions for a consolidated audit approach in areas such as: – large case files; – industry sectors; – special projects; – tax avoidance; and – quality assurance.	**Ongoing**
Audit and Special Investigations	The Department is taking steps to focus audit resources on activities such as:	
	• Joint Excise/GST and Income Tax audits are being pursued with the aim of co-ordinating and combining audits whenever possible.	**Ongoing**
	• Improved links to provincial counterparts are being undertaken, focussing on audit selection, audit coverage, information sharing, joint/complimentary audits, training, co-location if feasible and staff exchanges.	**Ongoing**
	• A move to a more analytical, less case-by-case approach to audit, using a core audit program to better identify non–compliance and possible solutions.	**June 1995**
	• The pursuit of special projects directed to non–compliance.	**Ongoing**
	• Combining audit techniques with industry knowledge to maximize effectiveness.	**January 1995**
	• An analysis of audit results with the aim of formulating legislative suggestions.	**Ongoing**
	• Completion of the audit information management system to monitor SR&ED*.	**April 1995**
Compliance Research	The Department has taken steps through Administrative Consolidation to strengthen compliance research. A Compliance Research Division is being established to better identify compliance and non–compliance and the factors that improve compliance. The Department is working with Department of Finance and provincial governments to develop information that will assist in detecting non–compliance. It will develop an improved overall compliance strategy and improve audit selection techniques. The work being done on Standard Industrial Classification (SIC) codes is an important element of this strategy.	**June 1995**
Underground Economy	This initiative focusses on non–compliance by: • increasing audits of small business files; • identifying areas of tax evasion through non–filers and non–registrants (including SIC codes on registrant information); • federal-provincial agreements; • consulting with industry and professional associations; • possible reporting and information changes (including steps to improve reporting of SINs on the T5 slips); • matching of data; and • increasing visibility in specific communities by visiting local businesses to provide helpful advice and to obtain information to ensure proper filing and registration.	**Ongoing**
Measurement Review Committee	The establishment of a departmental committee to identify and develop appropriate measurement criteria for audit programs.	**February 1995**

* *scientific research and experimental development.*

Source: Revenue Canada

Chapter 31

Revenue Canada

Ensuring Fairness of the Income Tax System: Detection of Non–Filers and Special Investigations

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Revenue Canada

Ensuring Fairness of the Income Tax System: Detection of Non–Filers and Special Investigations

Main Points

ENSURING FAIRNESS OF THE INCOME TAX SYSTEM: DETECTION OF NON–FILERS

31.1 Filing a tax return is central to the Canadian income tax system. It establishes the amount of tax owing and puts taxpayers on the tax roll so they can be monitored by Revenue Canada's enforcement programs, such as the Non–Filer Program. The purpose of the Non–Filer Program is to identify taxpayers who have failed to file current tax returns and to secure the required returns from them.

31.2 In 1993–94, Revenue Canada generated 509,000 tax returns through its Non–Filer Program, bringing in $124 million in income tax, plus an additional amount in interest and penalties. Over half of these returns were received as a result of reminder notices issued by the automated non–filer system. The remainder were obtained from follow–up by departmental staff of non–filers identified by the automated system, the document matching program, internal referrals and information from external sources. The Department has increased its use of external sources and is continuing its efforts to access other sources.

31.3 Due to missing social insurance numbers, the Department could not use automated document matching for millions of T5 slips. Limited manual tests of these slips, however, indicated that most taxpayers properly reported their T5 slips on tax returns. While there is a small penalty for failure to provide a social insurance number, no penalties have been assessed. Instead, the Department is consulting with financial institutions on a plan for action, either separate or joint, to improve social insurance number compliance. It intends to review the results of this effort before it reconsiders the need for a withholding requirement if a social insurance number is not provided.

31.4 The Non–Filer Program has resulted in hundreds of thousands of returns and millions of dollars of tax revenue due under the *Income Tax Act*, but the Department does not know how effective it has been in enhancing taxpayer compliance. For example, it does not know yet how many non–filers who are caught begin to file tax returns voluntarily thereafter. The Department is currently developing an automated system designed to capture information for an evaluation of the subsequent compliance of non–filers.

ENSURING FAIRNESS OF THE INCOME TAX SYSTEM: SPECIAL INVESTIGATIONS

31.5 Tax evasion is a serious criminal offence. It results in a loss of revenue; it shifts the tax burden from dishonest taxpayers to honest taxpayers; and it creates unfair competition between businesses that abide by the law and those that don't.

Main Points (cont'd)

31.6 Criminal prosecution can be a powerful incentive to comply with tax laws and thus deter tax evasion. The Department detects tax fraud through its audit and other enforcement activities, investigates suspected cases of tax evasion and, where appropriate, recommends them to the Department of Justice for prosecution. The Special Investigations Division of Revenue Canada is responsible for enforcing the criminal provisions of the *Income Tax Act*.

31.7 Suspected tax evasion cases identified by tax auditors and referred to Special Investigations have decreased by 50 percent from 1,000 to 500 a year since 1990.

31.8 Revenue Canada has planned to refer about 170 cases a year to the Department of Justice for prosecutions. This target is based on the resources that have been assigned to Special Investigations. It is not based on research to determine to what extent Special Investigations should be used in combatting tax evasion and in improving voluntary compliance.

31.9 In order to achieve its target of 170 prosecutions a year, the Department has reduced the number of preliminary investigations and limited the number of tax years and tax offences to be investigated and recommended for prosecution in each case; in addition, the Department has relied heavily on the acceptance of guilty pleas.

31.10 The main objective of special investigations and other enforcement activities is to improve voluntary compliance. However, Revenue Canada measures and reports the results of its various enforcement activities in terms of additional taxes reassessed, including penalties and interest. Measuring performance in terms of dollars of tax reassessed may encourage tax auditors to focus on potential dollar reassessments, which may be to the detriment of fulfilling the Department's obligation to detect tax evasion. Furthermore, this performance measure does not encourage accountability in achieving the objective of improving the level of compliance. The Department does not know the final disposition of those reassessments.

31.11 Compliance research is essential if Revenue Canada wants to pursue a strategy of maximizing revenue and voluntary compliance. Despite our audit recommendation in 1990, the Department abandoned its research function in 1992. Recently, however, the Department has announced an initiative to reintroduce compliance research.

ENSURING FAIRNESS OF THE INCOME TAX SYSTEM: DETECTION OF NON–FILERS

Introduction

The Non–Filer Program is key to maintaining the tax base

31.12 The income tax return is central to the Canadian income tax system, establishing either the amount of tax owing or the amount to be refunded. Income tax returns are the source of much of the information that Revenue Canada possesses about taxpayers and, as such, are integral to many of the processes that go on in the Department, for example, responding to taxpayer enquiries, conducting audits and handling appeals.

31.13 For the income tax system to operate fairly and efficiently, it is important that all individuals and corporations file returns when they are required by law to do so. For individuals, this is when they owe tax or meet other criteria, such as contributing to the Canada Pension Plan on self–employed earnings. Corporations must file returns annually, whether or not they owe tax.

31.14 The objective of Revenue Canada's Non–Filer Program is to identify taxpayers who have failed to file tax returns and to secure the required returns from them. If taxpayers have filed returns in the past, Revenue Canada will have their names on its tax roll, making identification fairly easy. For taxpayers who are not on the tax roll (unknown non–filers), the Department must obtain leads that it can follow to determine whether they do, in fact, need to file a return.

31.15 In some cases, Revenue Canada will prosecute taxpayers for failure to file a return. In a few cases, where it is warranted, the Department may choose to prosecute for tax evasion. The courts may impose a higher penalty for tax evasion than for failure to file. (See the section of this chapter on Special Investigations.)

Audit Objective and Scope

31.16 Our audit objective was to assess how Revenue Canada manages its Non–Filer Program. We focussed on its policies and related practices for obtaining individual and corporate income tax returns, and on its efforts directed to identifying those not currently on the Department's tax roll. Exhibit 31.1 lists the criteria we used during the examination.

31.17 We conducted our audit in Revenue Canada's head office and in selected district offices and taxation centres.

The tax return is central to the income tax system.

Exhibit 31.1

Audit Criteria – Detection of Non-Filers

- There should be policies and procedures in place to identify non-filers and to obtain tax returns, and resources to carry out these activities.
- The Department should use the information it holds to identify non-filers.
- The Department should seek and use other sources of information to identify areas of non-filing on which to direct effort and to find specific non-filers.
- There should be a system to gather, monitor and communicate information on the Non-Filer Program.
- The Department should evaluate the Non-Filer Program and report thereon.

Observations and Recommendations

The Non–Filer Program brings in hundreds of thousands of returns

31.18 In 1993–94, Revenue Canada generated 509,000 individual and corporate tax returns through its Non–Filer Program, bringing in a net amount of $124 million in income tax, plus an additional amount in interest and penalties. Approximately 20 million taxpayers file returns in a tax year.

31.19 Exhibit 31.2 illustrates a large increase in the number of returns generated through the Non–Filer Program over the last five years. The increase is due, for the most part, to the automated system having identified and sent notices to more non–filers, and to departmental staff having followed up on notices to which no response was received. The use of income information from additional types of information slips has enabled the Department to identify more individuals required to file tax returns.

Exhibit 31.2

Increase in the Number of Returns Generated by the Non–Filer Program over Five Years

	1989-90 (thousands)	1993-94 (thousands)
Automated system	232	300
Follow-up by staff:		
System initiated	113	173
Projects	13	36
Total	*358*	*509*

Source: Departmental records

31.20 In 1993–94, Revenue Canada received 307 tax returns as a result of prosecutions of taxpayers for failure to file a return. The taxpayers prosecuted were fined in total almost $1 million. The Department considers prosecutions a last resort to obtain a return from a non–filer. It attempts first to secure a return through its regular follow–up by departmental staff.

The Non–Filer Program has been given a boost through Revenue Canada's "underground economy initiative"

31.21 In 1993, the Department, as part of its underground economy initiative, began joint income tax–Goods and Services Tax (GST) audits in certain field offices directed at various sectors of the Canadian economy. (These audits are in line with the Department's 1992 announcement of an integrated approach to audit, intended to reduce the disruption to businesses.) As with other audits, when non–filers are identified by joint audits, they are referred to the Non–Filer Program.

31.22 This recent emphasis on the underground economy is reflected in increased resources for the Non–Filer Program. While the number of staff employed on the Non–Filer Program increased by 22 percent over five years, from 380 to 463, most of the increase occurred in 1993–94. In that year, the Department gave the Non–Filer Program permission to employ an additional 50 term staff–years in 15 of its field offices. (Term staff are hired for a specified period rather than on a permanent basis.) In employing the additional staff, the field offices were to deal with referrals from the underground economy initiative before handling the increasing inventory of regular non–filer cases. The staff–years employed on the Non–Filer Program in the 15 field offices,

however, increased by only 36 because of delays in hiring the term staff and a loss of staff who were transferred temporarily to other functions in the Department. Overall, the Non–Filer Program did not use 4 percent of its total budgeted staff complement in 1993–94.

31.23 For 1994–95, the Department increased by a further 149 the term staff allocated to the Non–Filer Program.

The automated process is an efficient means of obtaining returns

31.24 Of the 509,000 returns generated by the Non–Filer Program, 300,000 were received as a result of reminder notices issued by the automated system, without the need for follow–up by departmental staff. (In this report we refer only to reminder notices, but in practice, repeat non–filers may receive a "demand" to file.)

31.25 Each year, the Department's automated non–filer system identifies individual and corporate taxpayers on the tax roll who have not filed a current return and sends them a reminder notice. It sends a notice only to individuals for whom it estimates that a potential tax liability exists based on prior returns and third–party information slips. A second notice is sent automatically after 40 days if the taxpayer still has not filed a return.

31.26 Just obtaining a tax return is a vital part of compliance. It puts taxpayers on the tax roll, where they are easily monitored by the Department's non–filer system and other enforcement programs to determine the correct amount of tax. The fully automated process is an efficient way to obtain returns. The returns obtained through this process do not always produce additional tax revenue because a large number of the returns filed pursuant to reminder notices claim tax refunds. In 1993–94, the net reduction in tax revenue was $79 million.

Most additional tax assessments are obtained from follow–up by departmental staff

31.27 Follow–up actions by departmental staff accounted for the remaining 209,000 returns generated in 1993–94. Unlike the fully automated process, follow–up actions by departmental staff normally result in additional tax revenue for Revenue Canada ($203 million net in 1993–94). Each staff member brought in an average of 505 returns and $492,000 in additional tax assessments in 1993–94. This was well worth the effort, considering an average staff salary of $35,000 and the anticipated future tax revenue from non–filers who begin to file voluntarily.

31.28 This follow–up work arises from two sources. First, non–filer cases identified by the automated system are forwarded for follow–up to a field office if a return is not received after the second reminder notice. Most of the non–filer staff are devoted to this work, which resulted in $148 million in additional tax revenue for the 173,000 returns generated in 1993–94.

The fully automated non–filer process is an efficient way to obtain returns.

31.29 Second, the Department discovers known and "unknown" non–filers through its project work, that is, from the matching program, from referrals by other departmental units and from information it gathers from external sources, such as registries of building permits. Matching (see paragraph 31.32) identifies non–filers through information slips submitted by third parties. Of the returns received through projects, the majority result from matching and referrals. The use of external sources of information increases the possibility of finding non–filers. The Department realizes the importance of these sources

and is continuing its efforts to access them (see paragraphs 31.39 and 31.40).

31.30 Through its projects, the Department assessed $55 million in additional tax revenue for 36,000 returns in 1993–94. On average, a staff member assigned to project work brings in fewer returns in a year than a staff member assigned to automated–system follow–up actions, but projects result in more tax revenue per staff member in a year (see Exhibit 31.3). The number of returns is lower due to the greater time involved in handling project cases. However, these efforts do result in new taxpayers being brought onto the tax roll.

31.31 Revenue Canada does not obtain a return from all non–filers it identifies. To handle its workload with available staff, the Department establishes tolerance levels — levels of potential tax liability or income below which it does no follow–up. It also may discontinue follow–up action in other circumstances, such as for deceased individuals and inactive corporations. The automated system issued 464,000 reminder notices to individuals and 263,000 to corporations for the 1991 tax year. In one third of the cases for individuals and half of the cases for corporations, follow–up action was discontinued for the reasons noted above. Discontinued cases represent a potential source of returns that could be tapped if more staff were available to assess them for the amount of tax owing or the amount to be refunded.

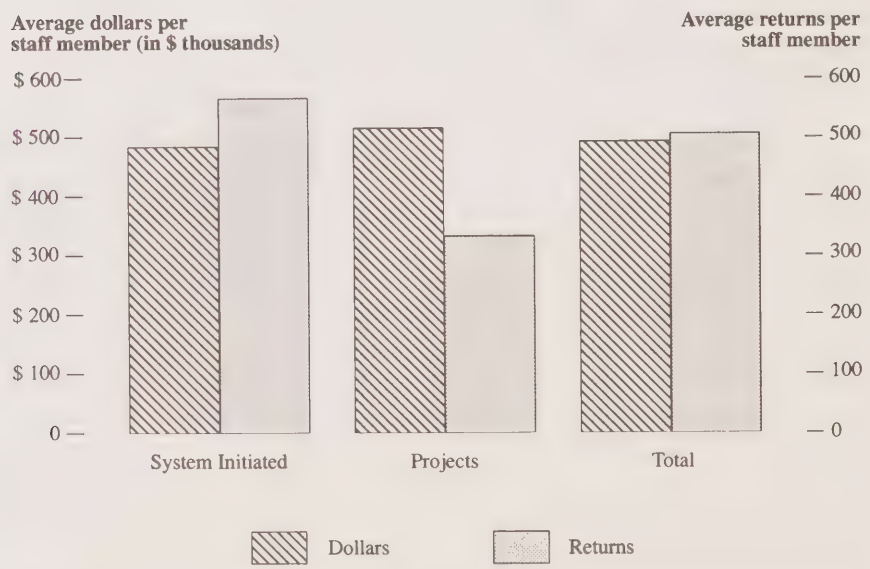
Absence of social insurance numbers on T5 slips hinders the Non–Filer Program and other enforcement programs

31.32 Revenue Canada identifies non–filers as one output of its matching program. Matching involves the computerized comparison of income and deductions reported on individuals' tax returns against information slips received from third parties. This includes the T4 slip from employers and the T5 slip from financial institutions.

31.33 The Department requires social insurance numbers (SINs) to link information slips to tax returns. Without

Exhibit 31.3

Average Number of Returns and Dollars per Staff Member in 1993–94



Source: Departmental records

SINs it can not include information slips in its automated matching. Manual matching is very time–consuming and costly and is therefore rarely used. The Department is developing a method of automatically matching individuals' tax returns against information slips without SINs. This method uses taxpayers' names and addresses or accesses other departmental data bases to search for their SINs.

31.34 Because SINs were missing, the Department could not use automated matching for over 6.5 million, or 27 percent, of the 24 million 1992 T5 slips it received. A portion of these slips pertains to recipients who do not require a SIN, such as corporations. An estimated 5 million T5 slips without SINs pertain to individuals. (A more exact count cannot be made because the T5 data file contains incorrect and missing codes for signifying the type of recipient.)

31.35 To assess the extent to which income has been under–reported or tax returns have not been filed by recipients of T5 slips without SINs, Revenue Canada conducted limited manual matching tests. As would be expected, the results indicated that most taxpayers properly reported the information on their tax returns, but some did not report the amounts and a few did not file tax returns.

31.36 The Department has been aware of the problem of missing SINs for several years. A 1988 *Income Tax Act* amendment provides for a $100 penalty when taxpayers fail to provide their SIN to their financial institutions and financial institutions do not make reasonable efforts to obtain and report this number to Revenue Canada. Despite the high incidence of missing SINs, no penalties have been assessed. The Department has concluded that the penalty provision would be both difficult and costly to enforce. Instead, it has concentrated on informing taxpayers of the law and on encouraging financial institutions to obtain and report SINs.

31.37 The Internal Revenue Service in the United States requires withholding of tax if an identification number is not provided. Revenue Canada and the Department of Finance have discussed a possible change in the law to require withholding of tax by financial institutions if a valid SIN is not provided. In 1995, Revenue Canada intends to reconsider this possibility after reviewing the results of current consultations with financial institutions to develop a plan for action, either separate or joint, to improve SIN compliance.

31.38 The Department should continue with its initiative to obtain social insurance numbers for those information slips pertaining to individuals (see Exhibit 31.7). In view of the apparent problem with the current penalty provision, the Department should investigate other options, including reconsidering a withholding requirement, in cases where a valid SIN is not provided and recommend legislative changes.

Department's response: *The Department is continuing its initiative of obtaining SINs on T5 slips through negotiations with the financial community. The Department will periodically assess the effectiveness of its approach to improve the SIN compliance level. If progress is not achieved, the Department will consider other alternatives including legislative measures.*

Because SINs were missing, the Department could not use automated matching for millions of T5 slips.

The Department needs to continue improving its ability to generate non–filer leads

31.39 Revenue Canada realizes that information from sources outside the Department provides valuable leads for

the identification of non–filers. Individual field offices have undertaken projects using publicly available information and information voluntarily provided by third parties. The information sought, which varied from office to office, included lists of building permits and payments to contractors.

31.40 In 1993–94, the Department identified, at a national level, a number of external data bases, including information from other federal departments and provincial governments. It has gained permission to use some of the data bases and is working on gaining permission for the others. The information from these data bases is for use in several enforcement programs, including the Non–Filer Program. At the time of our audit, the majority of the identified data bases were not yet available for departmental use.

31.41 Revenue Canada recently started matching a number of its internal data bases, which were not linked by a common identification number. The Department cross–matched the filers in its employer deductions, GST and corporate tax accounts using their names and addresses. It intends to conduct tests to assess whether this process could be used to identify corporate non–filers.

31.42 The data bases noted above are intended to identify non–compliance by specific taxpayers. The Department, however, could complement this work by performing compliance research using other data bases to provide a profile of who the non–filers are. As an example, using the 1991 aggregated census data, we compared the number of individuals who stated they had income in 1990 with the number who filed returns for 1990. The results were interesting.

31.43 While not conclusive, our comparison suggests a large number of potential non–filers in the under–20 age group. For those in the under–20 group with incomes greater than $20,000, we found that 80 percent of males and 55 percent of females filed returns. At those income levels we would have expected a higher percentage of filers. The discrepancy between expected and actual filing percentages may be explained by persons having non–taxable types of income or sufficient deductions to put them in a non–taxable position. Or, it may be explained by new entrants to the labour force, particularly those who are self–employed, who do not file returns as required.

31.44 The Department needs to do compliance research that analyzes information of this sort for use in the design of its compliance strategy. By having a picture of who the non–filers are, Revenue Canada can address non–filer groups more effectively. For example, an education program targeted to younger income earners might bring more members of this group onto the tax roll.

31.45 The Department's compliance research initiative (see Exhibit 31.7) should attempt to provide profiles of non–filers to assist in the design of departmental programs.

Departmental response: *The Department, as outlined in Exhibit 31.7, will establish a Compliance Research Division to strengthen and expand our compliance research capacity.*

With respect to the development of non–filer profiles, departmental evidence gathered over the years clearly shows that little variance exists between non–filers and regular taxpayer profiles. Non–filers are most effectively identified by measures such as in–depth reviews of

sectors/industries, improving reporting legislation and matching of data.

The Department needs to improve further the availability of information on the Non–Filer Program

31.46 While head office sets policy for the Non–Filer Program, field offices carry out the program and decide what work to undertake and how much time to devote to it. The decisions that field offices are required to make in particular circumstances include the type of work to undertake, the external data bases to use, the tolerance levels for deciding which cases to follow up, the length of time to have cases in inventory and the percentage of staff time to devote to project work. In order to evaluate the appropriateness of decisions, managers need more information than is currently available.

31.47 The Department's ability to manage its Non–Filer Program is hindered by the limitations of its computer information systems. Currently it uses three computer systems to record and report Non–Filer Program results. Data must be separately entered in both local and national systems. These systems do not provide the same information, contain different totals due to timing differences and, in some cases, do not properly and consistently accumulate data. The national systems do not allow for timely ad hoc reporting.

31.48 In 1989, Revenue Canada started a project to develop a new system to replace the three current systems and to automate some manual procedures. The purpose of the new system is to solve problems encountered with the current systems and to make the Department's operations more efficient. For the new system, the Department is developing a scoring method to identify non–filing individuals with the highest potential tax liability for follow–up by field offices. In 1991, the project was delayed, and a project development team was not established until June 1992. Now it is scheduling implementation of the new system in stages from 1995 to 1996.

31.49 Until recently, the field offices learned about other offices' successful projects primarily in an informal manner. The advent of electronic communication has allowed a faster and more efficient way of getting information on projects to all offices and has been used by head office for this purpose since March 1993. Head office encourages its field offices to send in information on their project experience for electronic distribution to all offices, but input from field offices has been disappointing. Submissions have been received from only 7 of the 38 district offices, and most came from one office.

The Department needs to evaluate the effectiveness of the Non–Filer Program

31.50 The Department measures the results of the Non–Filer Program by the number of returns obtained, taxes assessed and staff time used. These are measurements of the direct results of the program. We would like to see other measures, such as the extent to which the Department is succeeding in enhancing taxpayer compliance compared to the potential that exists. The number of non–filers added to the tax roll would be one measure, but these data are not compiled.

A fundamental purpose of the program is to foster future voluntary compliance.

31.51 Revenue Canada considers that a fundamental purpose of its compliance programs is to foster future voluntary compliance. The Department does not know whether it is successful in this regard. For example, it does not know how many non–filers who are caught begin to file tax returns voluntarily thereafter or how many remain non–filers.

Its current computer systems produce a report on compliance history of non–filers, but the Department considers it unreliable. (One of the purposes of the new automated system mentioned in paragraph 31.48 is to provide information for an evaluation of the subsequent compliance of non–filers.) A study that the Department expects to complete at the end of December 1994 on one part of the non–filer workload includes the issue of taxpayers' future compliance. Our work on a number of non–filer cases suggests repeat non–filers are a definite problem. A more in–depth analysis of taxpayer behaviour by the Department would be necessary to assist it in directing program efforts to enhance future compliance.

Tax evasion is a serious criminal offence.

31.52 Through the work of the Measurement Review Committee (see Exhibit 31.7), the Department should establish appropriate, reliable measures for evaluating its Non–Filer Program. In addition, it should continue its efforts to develop the new automated system to provide information for evaluating the Non–Filer Program.

Department's response: The Department's Measurement Review Committee will identify and develop appropriate measurement criteria for audit programs.

Additionally, the Department is in the process of implementing an automated system that will assist the Department in measuring the effectiveness of the Non–Filer Program.

Conclusion

31.53 The Department recognizes that obtaining tax returns is a vital aspect of ensuring compliance with the *Income Tax Act*. The Non–Filer Program has been in place for many years and has concentrated on following up on non–filers who are already on the tax roll and are identified by the automated system. The Department needs to continue expanding its use of both internal and external sources of information to conduct compliance research and to generate more non–filer leads to find those not on the tax roll. The program has resulted in hundreds of thousands of returns and millions of dollars of tax revenue due under the *Income Tax Act*, but the Department needs to evaluate its effectiveness in achieving behavioural change among the non–filer population.

ENSURING FAIRNESS OF THE INCOME TAX SYSTEM: SPECIAL INVESTIGATIONS

Introduction

31.54 Tax evasion is a serious criminal offence. The Minister of National Revenue in a recent speech on tax evasion noted that the underground economy and tax evasion affect government services and are making it difficult for governments to reduce deficits and eventually cut taxes. He noted further that people do get hurt; tax evasion is not a victimless crime. Jobs are lost, honest taxpayers carry an unfair load, and legitimate businesses are forced to operate against unfair competition.

Criminal prosecution can be a powerful incentive to comply with tax laws and thus deters tax evasion.

31.55 The *Income Tax Act* provides for the criminal prosecution of income tax fraud. Criminal prosecution can be a powerful incentive to comply with tax laws and thus deters tax evasion. The deterrent effect operates at two levels: at the taxpayer level through prosecution and the imposition of fines and jail sentences and, at a more general level, through publicizing convictions.

31.56 The Special Investigations Division of the Department is responsible for enforcing the criminal provisions of the *Income Tax Act* (Act). It investigates suspected cases of tax evasion and, where appropriate, recommends them to the Department of Justice for prosecution. (See Exhibit 31.4). Cases investigated are usually referrals from other enforcement activities, in particular, audit.

31.57 In addition, Special Investigations carries out audits under the Special Enforcement Program (SEP) to determine the taxes payable by persons who are earning income from illegal activities and who may be subject to prosecution for other criminal offenses by the Royal Canadian Mounted Police (RCMP) or other law enforcement bodies. Special Investigations also processes applications for the voluntary disclosure of previously undeclared income and tax and accepts information from informants on suspected tax evasion.

31.58 To obtain a conviction for tax evasion, the Department must have sufficient evidence to prove that the taxpayer willfully intended to commit evasion. The proof of the taxpayer's intent is analogous to that required to prove the Criminal Code offence of fraud. Neglecting to report income does not in itself necessarily constitute tax fraud or evasion. However, deliberately submitting a false or misleading tax return with the intent of having the Minister of National Revenue act upon it as true does constitute tax fraud.

31.59 In investigated cases where willful intent cannot be proved, the Department does not pursue criminal prosecution but may impose a gross negligence penalty of 50 percent of the tax reassessed.

31.60 Special Investigations has a budget of 464 people, who account for about 8.5 percent of person–years allocated to Revenue Canada's post–assessing compliance activities for 1994–95. Staff resources utilized in Special Investigations activities have declined by 10 percent since 1989–90.

Audit Objective and Scope

31.61 Our audit objective was to assess the adequacy of Revenue Canada's enforcement activities carried out to detect and prosecute income tax evaders. We also assessed the adequacy of the information provided to Parliament to assist it in reviewing these operations.

31.62 Our examination included the Special Investigations Division and other departmental enforcement activities that have a bearing on the Division's operations. We conducted interviews at head office and certain district offices. We also interviewed criminal prosecutors of the Department of Justice involved in the prosecution of suspected tax evasion cases.

Exhibit 31.4

Special Investigations Operations

	1990	1991	1992	1993
Preliminary investigations	262	187	151	181
Full investigations not referred to Justice	41	34	33	41
Referrals to Justice	165	142	156	154
Total cases investigated	468	363	340	376
Special Enforcement Program audits	282	290	328	340

Source: Revenue Canada, 1994–95 Estimates, Part III

The success of the Special Investigations program is dependent on a continuing flow of leads. A significant proportion of leads to tax evasion should come from those engaged in the verification of tax returns and the examination of taxpayer records.

To try to meet its plan, Revenue Canada has reduced the number of preliminary investigations, limited the number of tax years and tax offences to be investigated and relied heavily on the acceptance of guilty pleas.

Observations and Recommendations

The identification of suspected tax evasion cases by tax auditors has decreased by 50 percent from 1,000 to 500 a year since 1990

31.63 The Special Investigations program depends on a constant flow of referrals from other departmental units. The Department realizes the importance of this flow; its operations manual states:

> The success of the Special Investigations program is dependent on a continuing flow of leads. A significant proportion of leads to tax evasion should come from those engaged in the verification of tax returns and the examination of taxpayers records. **Management in all Sections at Head Office and District Offices should instruct staff under their control to be on the alert for indications of wilful non–compliance with any of the Acts administered by the Department.** They should ensure that all cases where criminal investigations may be warranted are referred to Special Investigations.

31.64 Over the last four years, annual referrals to Special Investigations from other departmental activities, principally audit, have declined from 1,000 to 500. A decline in audit referrals reduces the pool of cases from which the Division develops its investigations and prosecutions. It may weaken the ability of the Department to achieve its objective of maintaining a consistent and balanced program of criminal prosecution across all taxpayer segments and geographical areas.

31.65 The decline in referrals was of concern to the Department. In 1993–94, head office requested its district offices across Canada to significantly increase their workload development efforts to generate 1,296 referrals to Special Investigations. The Department informed us that, in 1993–94, the actual number of referrals was 490.

31.66 In our discussions with senior departmental officials, we were informed that part of the decline may be attributed to improved quality and complexity of the cases referred by audit. However, we have not been provided with evidence of this improvement.

Planned referrals for prosecutions are 170 cases a year

31.67 Investigations to prove the criminal intent of tax evasion and the dollar value of fraud are labour–intensive and time–consuming. An average investigation takes over 2,000 direct hours — about one and a half person–years. The completion of the court stage by the Department of Justice takes, on average, two years of elapsed time. In recent years, the conduct of an investigation has become more time–consuming because of the need to comply with the procedural protection of the Charter of Rights.

31.68 Evidence to support charges of tax evasion is obtained mainly through the use of investigations and searches authorized by a warrant. Investigators will not recommend cases for prosecution unless the evidence is reviewed by the Department of Justice and strongly supports the charges of tax evasion.

31.69 In the last five years, Revenue Canada planned to refer about 170 suspected tax evasion cases a year to the Department of Justice for prosecution. Actual referrals were approximately 150 per year. The target of 170 referrals a year is based on the resources that have been assigned to Special Investigations. It is not based on research to determine to what extent criminal prosecution should

be used in combatting tax evasion and in improving compliance.

31.70 We noted that in order to try to meet the budgeted number of referrals for prosecution, the Department has reduced the number of preliminary investigations and limited the number of tax years and tax offences that it includes in its investigations and recommendations for prosecution in each case. It has also relied heavily on the acceptance of guilty pleas to reduce the time required per case.

31.71 Department of Justice prosecutors that we interviewed indicated that the Special Investigations files were usually well prepared and supported the recommended charges. Over the past four years, charges were laid in over 90 percent of the recommended cases, and 90 percent of prosecutions resulted in a conviction (see Exhibit 31.5).

31.72 Sixteen percent of convictions are the result of a trial; 84 percent are obtained through the acceptance of guilty pleas. The files indicate that some of these pleas are obtained by negotiating the charges and the sentence with the taxpayer. In these cases, the amount of tax subject to charges of evasion, the number of tax years involved, the value of civil penalties to be imposed, and the number of taxpayers involved in the tax fraud, as well as the proposed criminal sentence or fine, may be reduced in exchange for a guilty plea and the payment of tax liabilities owed to the Crown. The acceptance of guilty pleas ranges from 94 percent in Montreal to 73 percent in Vancouver.

31.73 Guilty pleas have always been used in resolving tax evasion cases. In fact, they are used throughout the criminal justice system. Cases with guilty pleas are less expensive because they reduce the work of investigators by minimizing the need to prepare evidence for trial. These cases take, on average, 600 fewer hours than trial cases. The time spent in court by taxpayers and their representatives, as well as by Justice lawyers, is also reduced.

Conviction publicity has been reintroduced

31.74 Prosecutions are pursued to sanction non–compliance of specific taxpayers and also to deter other taxpayers from similar breaches of the statutes. General deterrence theory suggests that to achieve their greatest impact, the convictions obtained by successful prosecutions must be given wide publicity. In addition to its deterrent value, publicity also serves to reassure honest taxpayers that they are not expected to pay for those who are dishonest.

31.75 In 1987, the Department adopted a policy of not initiating contacts with the media on prosecutions. We indicated in our 1990 report on enforcement that a large decline in the publicity generated by prosecutions for tax evasions had resulted from this policy.

31.76 A new publicity policy was introduced in August 1993 and formally put in place in January 1994. The policy calls for a national press release on tax

Exhibit 31.5

Prosecutions and Other Results

	1990	1991	1992	1993
Prosecutions completed	123	123	149	144
Convictions obtained	113	111	136	134
Federal tax upon conviction ($ millions)	13.8	8.9	22.4	12.1
Fines ($ millions)	16.2	4.5	15.0	6.6
Mandatory jail sentences	9	10	11	8

Source: Revenue Canada

evasion prosecutions involving taxes of $250,000 or more and on cases of national interest. A regional press release goes out on tax evasion cases involving less money. The charge, the case details, the penalty and the identity of the offender are included in these press releases.

31.77 The Department has advised us that it intends to further develop proactive approaches to disseminate information on successful prosecutions and other fraud issues.

Publicity seems to have had a positive influence on delinquent taxpayers.

31.78 Our review of departmental records indicates that publicity seems to have had a positive influence on delinquent taxpayers. In the last fiscal year, the number of voluntary disclosures of taxes previously unreported has increased by more than 100 percent, from 268 to 587. Departmental publicity was the reason most often cited for making voluntary disclosures last year.

The results of current enforcement activities are measured and reported in additional tax dollars reassessed

31.79 The Department indicates in its Part III of the Estimates that all its enforcement activities, including Special Investigations (SI), are undertaken either to foster taxpayer self–assessment or to enhance compliance with the law. However, the performance of all enforcement activities, including SI, is measured and reported primarily in terms of dollars of tax reassessed. But tax reassessments are not a measure of improved voluntary compliance.

Measuring performance in terms of dollars of tax reassessed may be to the detriment of fulfilling the Department's obligation to detect tax evasion.

31.80 Measuring performance in terms of dollars of tax reassessed may encourage tax auditors to focus on potential dollar reassessments, which may be to the detriment of fulfilling the Department's obligation to detect tax evasion. Furthermore, this performance measure does not encourage accountability in achieving the objective of improving the level of compliance.

31.81 The Department does not know the final disposition of reassessments issued through its enforcement programs — what was collected, what was uncollectable and what was reversed by the internal appeal process or by the courts. The Department's Part III of the 1994–95 Estimates state that "all efforts devoted to fostering self–assessment and enforcing compliance would prove fruitless unless the revenues assessed are eventually collected by the government." However, the Department does not record the extent to which reassessments issued after criminal investigations were collected or were written off. Providing Parliament with information on the final disposition of tax reassessments in performance measurement would provide a more complete picture of the impact of enforcement activities.

Research on compliance is essential for improving voluntary compliance

31.82 In 1990, we recommended that the Department do more research on compliance. In 1992, the Department advised us that it was committed to reviewing its research operations and requirements. In the same year, the Department abandoned its research function and replaced it with a planning function for audit that is not adequately staffed to do compliance research. The Department recently announced an initiative to reactivate its compliance research function. At the completion of this audit, this initiative had not been operationalized.

31.83 At present, the Department does not carry out research on how specific enforcement actions contribute to increased compliance and, in particular, how the criminal sanction improved

compliance in specific industries or communities. To maximize improvements to the level of voluntary compliance with a given amount of resources, the Department must conduct research to gain knowledge as to what effect various enforcement activities have on compliance. Compliance research could help detect significant areas of non–compliance and assist in evaluating the performance of enforcement activities.

31.84 As a result of our audit, we have identified some suggested questions for compliance research. These compliance research questions are shown in Exhibit 31.6.

31.85 A systematic program of research is essential if the Department wants to pursue a strategy of maximizing revenue and voluntary compliance.

31.86 The Department should:

- **use its compliance research initiative (see Exhibit 31.7) to enable it to evaluate and continually improve its enforcement activities, including Special Investigations, with a view to maximizing voluntary compliance and revenue;**

- **through the work of the Measurement Review Committee (see Exhibit 31.7), develop performance measurements for enforcement activities to address the objective of improving voluntary compliance;**

- **provide Parliament with information on the final disposition of the reassessments issued through its enforcement activities and on its research activities.**

Department's response: *The Department, as outlined in Exhibit 31.7, is taking appropriate steps to establish a Compliance Research Division mandated to maximize voluntary compliance and revenue generation.*

The Department's Measurement Review Committee will identify and develop appropriate measurement criteria for audit programs.

The Department, as part of the Measurement Review Committee's mandate, will review the feasibility of providing information on the final disposition of reassessments issued through audit programs and on its research activities.

Exhibit 31.6

Some Suggested Questions for Compliance Research

1. What impact has the decline in audit referrals to Special Investigations had on deterring tax evasion?
2. What priority should the Department assign to the role of Special Investigations in combatting tax evasion? What initiatives could best reduce tax evasion?
3. What should the role of deterring tax evasion be in an overall compliance strategy?
4. How effective has the gross negligence penalty been in deterring non–compliance and tax evasion?
5. What is the effect of various enforcement activities on compliance improvement?

As a result of our audit, we have identified some suggested questions for compliance research.

Exhibit 31.7

Initiatives the Department Has Under Way to Improve Verification, Enforcement and Compliance Research

Initiative/ Plan	Description	Target Date
Administrative Consolidation	The Verification, Enforcement and Compliance Research Branch provides policies, programs, procedures and functional guidance and direction related to GST/Excise and Income Tax verification and enforcement. This includes the provision of client assistance related to these functions and responsibility for international verification and enforcement activities, excluding those related to Customs, and for strategies to penetrate the underground economy. Federal-provincial co-ordination is also a responsibility of this Branch. The Administrative Consolidation provides the opportunity to organize and to achieve directions for a consolidated audit approach in areas such as: – large case files; – industry sectors; – special projects; – tax avoidance; and – quality assurance.	**Ongoing**
Audit and Special Investigations	The Department is taking steps to focus audit resources on activities such as: • Joint Excise/GST and Income Tax audits are being pursued with the aim of co-ordinating and combining audits whenever possible. • Improved links to provincial counterparts are being undertaken, focussing on audit selection, audit coverage, information sharing, joint/complimentary audits, training, co–location if feasible and staff exchanges. • A move to a more analytical, less case-by-case approach to audit, using a core audit program to better identify non–compliance and possible solutions. • The pursuit of special projects directed to non–compliance. • Combining audit techniques with industry knowledge to maximize effectiveness. • An analysis of audit results with the aim of formulating legislative suggestions. • Completion of the audit information management system to monitor SR&ED*.	**Ongoing** **Ongoing** **June 1995** **Ongoing** **January 1995** **Ongoing** **April 1995**
Compliance Research	The Department has taken steps through Administrative Consolidation to strengthen compliance research. A Compliance Research Division is being established to better identify compliance and non–compliance and the factors that improve compliance. The Department is working with Department of Finance and provincial governments to develop information that will assist in detecting non–compliance. It will develop an improved overall compliance strategy and improve audit selection techniques. The work being done on Standard Industrial Classification (SIC) codes is an important element of this strategy.	**June 1995**
Underground Economy	This initiative focusses on non–compliance by: • increasing audits of small business files; • identifying areas of tax evasion through non–filers and non–registrants (including SIC codes on registrant information); • federal-provincial agreements; • consulting with industry and professional associations; • possible reporting and information changes (including steps to improve reporting of SINs on the T5 slips); • matching of data; and • increasing visibility in specific communities by visiting local businesses to provide helpful advice and to obtain information to ensure proper filing and registration.	**Ongoing**
Measurement Review Committee	The establishment of a departmental committee to identify and develop appropriate measurement criteria for audit programs.	**February 1995**

* scientific research and experimental development

Source: Revenue Canada

Chapter 32

Department of Finance and Revenue Canada

Income Tax Incentives for Research and Development

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Department of Finance and Revenue Canada

Income Tax Incentives for Research and Development

Main Points

32.1 As part of its investment in science and technology, the federal government has encouraged research and development in the private sector through various income tax provisions for many years. Canadian companies have taken up the incentives in increasing numbers over the past few years and are now claiming over $1 billion of investment tax credits annually.

32.2 In common with most tax provisions, the tax incentives for scientific research and experimental development are demand–driven. Every taxpayer who complies with the incentive provisions of the *Income Tax Act* is entitled to the benefits. Low levels of eligible spending by taxpayers result in low costs to the government. High levels of spending by taxpayers result in high costs. Ongoing and thorough monitoring of the incentives is required to manage the costs properly.

32.3 In the past four years, many taxpayers have refiled tax returns for prior years after learning that they had carried out qualified activities but had not claimed the investment tax credits. The 1994 Budget proposed changes restricting expenditures that qualify for the tax credits to those that the taxpayer identifies no later than 18 months after the year in which the expenditures were incurred. This will help the Department of Finance in its monitoring of the costs of the incentives.

32.4 The Department of Finance needs to monitor these tax incentives more thoroughly and systematically, in order to control their costs in foregone revenue and to ensure that the types of activities that qualify under the definitions and rules in the *Income Tax Act* are those the government wants to encourage.

32.5 Data are an integral part of monitoring the incentives for both the Department of Finance and Revenue Canada. Better and more reliable data need to be collected.

32.6 The Department of Finance has plans to evaluate the tax incentives for research and development and has identified important issues to be addressed. We encourage the Department to complete the evaluation studies and to publish the results as quickly as possible.

32.7 The Department of Finance needs to improve its accounting for the tax incentives for research and development, particularly in the areas of projected costs and actual results. It is important for Parliament and the Canadian public to know what these incentives are achieving and what they are costing.

32.8 In addition to its usual work of reviewing claims for compliance with the *Income Tax Act*, Revenue Canada has taken new approaches to delivering the tax incentives for research and development. It has improved its review process so that all claims are now subject to some minimum verification. However, the increasing workload is putting pressure on the Department's ability to administer the incentives in a timely and consistent manner.

Introduction

Encouraging research and development through the tax system

32.9 There are many ways for the government to achieve its economic and social objectives. The most visible is direct government spending on programs, grants and subsidies. The government also pursues its policy objectives through measures (such as tax deductions, credits, exclusions and income tax deferrals) contained in the income tax system. Because those measures represent alternative forms of government assistance, with financial implications similar to those of direct expenditures, they are generally referred to as tax expenditures.

32.10 As part of its investment in science and technology, the federal government has encouraged research and development in the private sector for many years through various income tax provisions. Exhibit 32.1 sets out a brief history of tax incentives for research and development.

32.11 The Department of Finance (Finance), which is responsible for overall policy relating to the tax system, has set out certain objectives for research and development tax incentives at various times over the past 12 years. The most comprehensive statement of objectives is found in the 1983 paper entitled *Research and Development Tax Policies*. In summary, these objectives are:

- to encourage research and development by the private sector in Canada;
- to promote research and development activities that conform to sound business practices;
- to provide tax incentives for research and development that, as much as possible, are of immediate benefit to businesses; and
- to provide tax incentives for research and development that are as simple to understand and comply with and as certain in application as possible.

Design of the tax incentives

32.12 The federal tax incentives currently available for qualifying research and development activities essentially consist of:

- deductions for eligible current and capital expenditures related to scientific research and experimental development undertaken in Canada directly by, or on behalf of, the taxpayer and related to the taxpayer's business. Eligible expenditures each year are added to the taxpayer's pool of expenditures for scientific research and experimental development. Amounts in the pool can be written off at the taxpayer's discretion, up to the total amount in the pool.
- investment tax credits on eligible current and capital expenditures made in Canada. These can be claimed at rates of 20, 30 or 35 percent; they are refundable in some cases. (The 1994 Budget proposes to eliminate the 30 percent rate.) Investment tax credits deducted from taxes payable or refunded must be deducted from the pool of eligible expenditures in the subsequent year.

32.13 Determining qualifying activities. The incentives are directed to scientific research and experimental development (SR&ED), which is defined under regulation 2900 of the Income Tax Regulations to mean a "systematic investigation or search carried out in a field of science or technology by means of experiment or analysis." The regulation goes on to indicate that work undertaken to advance scientific knowledge or to achieve technological advancement for

As part of its investment in science and technology, the federal government has encouraged research and development in the private sector for many years through various income tax provisions.

the purposes of creating new, or improving existing, materials, devices, products or processes will qualify. Certain activities, such as those related to market research or sales promotion, are specifically excluded from the definition.

32.14 Revenue Canada, in consultation with Finance and other federal departments and agencies and with industry representatives, has developed three criteria to help it and taxpayers determine whether particular activities fall within the definition and therefore qualify for the incentives. Those criteria are:

- scientific or technological advancement — the activity must generate information that advances our

Exhibit 32.1

History of Tax Incentives for Research and Development

Pre–1983	• Current and capital expenditures on research and development fully deductible in the year incurred • Investment tax credit for both current and capital expenditures with limits on how much could be deducted from taxes otherwise payable • Incremental allowance of 50 percent of current and capital expenditures in excess of the average level over the previous three years
1983	• Incremental allowance eliminated • Investment tax credit rates increased • Limits on deductibility of investment tax credits eliminated • Partial refundability of unused investment tax credits introduced • Amendments made to investment tax credit carry–over provisions • Scientific research tax credit flow–out mechanism introduced
1985	• Scientific research tax credit mechanism eliminated • Refundability of unused investment tax credits extended • Term "scientific research" recast as "scientific research and experimental development" (SR&ED) • Rules introduced to limit use of incentives when control of the taxpayer changes • Requirement introduced that investment tax credits be calculated on eligible expenditures net of any related assistance
1986–87	• Eligible expenditures extended to include payments related to research and development made to federal granting councils • Buildings excluded from eligibility for incentives • Rules requiring that expenses be "related to the business" clarified • Rules implemented constraining the syndication of SR&ED incentives through partnerships • Revised limits on deductibility of investment tax credits reintroduced
1992	• Optional proxy method introduced for determining SR&ED overhead expenditures for purposes of the investment tax credit • Partial tax credit introduced for equipment that is used primarily, but not all or substantially all, for SR&ED
1993	• Limits on deductibility of investment tax credits eliminated
1994	• Elimination of special rules for sole–purpose SR&ED performers proposed • Requirement introduced that, to be eligible for the incentives, SR&ED expenditures must be identified no later than 18 months following the year in which the expenditures were made

understanding of scientific relations or technologies;

- scientific or technological uncertainty — whether a given result or objective can be achieved and how to achieve it are not yet known or able to be determined on the basis of generally available scientific or technological knowledge or experience; and

- scientific and technical content — the activity must incorporate a systematic investigation and be carried out by qualified personnel.

32.15 Qualifying activities do not have to be carried out in a laboratory by scientists. Many occur in manufacturing plants, on the shop floor or in an office. For example, incremental improvements to existing products, improvements to the way products are manufactured and new software programs may all qualify if they meet the criteria set out above. Activities such as data collection and testing that are required to carry out qualifying activities are also eligible for the tax incentives. Exhibit 32.2 gives an indication of the range of activities that may qualify for the tax incentives if the requirements of the Income Tax Regulations are met.

Qualifying activities do not have to be carried out in a laboratory by scientists.

32.16 Determining eligible costs. Generally, expenses that are directly attributable to qualifying activities (for example, salaries, benefits, materials and appropriate overheads) are eligible for the tax incentives. In December 1992, the government proposed a proxy method for dealing with overhead expenses related to scientific research and experimental development activities, to reduce the burden on taxpayers and Revenue Canada

Exhibit 32.2

Examples of Activities That May Qualify for the Scientific Research and Experimental Development Tax Incentives

Note: These activities will qualify for the tax incentives only if they incorporate a systematic investigation by means of experimentation or analysis and meet all the other requirements of the Income Tax Regulations.

- Developing a new line of fibreglass windows and improving window hardware and locking mechanisms.
- Developing processes for the recycling of a wide range of solid waste materials, such as wood, plastics, glass, tires, construction waste and cardboard.
- Designing and developing a machine that assembles hanging file folders from paperboard blanks and runners.
- Developing an automatic guidance system for underground mining vehicles.
- Developing software relating to interfaces for weigh scales, bar coding and digitizers.
- Developing new software for an on–line, fully functional, detailed general ledger system.
- Developing an on–line system to validate credit information.
- Developing a comprehensive payroll system for personal–type computers.
- Designing and developing computer–controlled multimedia products using graphics, video, sound and text, and three dimensional images.
- Developing an integrated material handling/optics/computer system to inspect fruit after mechanical halving and pitting.
- Developing improved tomato cultivars and hybrids that have superior qualities for production and processing.
- Developing a single component polyurethane foam system that is ozone-friendly.
- Designing, developing and testing a landing gear control unit.
- Developing unreinforced and fibre–reinforced polymer modified cementitious material systems for products that provide coatings for rust protection and waterproofing of cement surfaces.
- Developing a new synthetic rubber polymer for industrial roll covering products.
- Researching and developing human diagnostic and therapeutic health care products.
- Developing new drugs based on their effects on leukotriene–mediated diseases such as asthma.
- Developing medical diagnostic instruments for heart valve problems.
- Developing devices to rapidly detect cardiovascular risk.
- Developing more environmentally acceptable muds for drilling to replace oil–based muds without compromising drilling performance.
- Developing a process to bleach kraft pulp to a specific brightness without using chlorine.

for determining eligible overhead expenses. This proposal was passed into law on 12 May 1994. Revenue Canada allowed taxpayers to use the proxy method for taxation years ending after 2 December 1992 if they elected to do so.

32.17 Safeguarding federal revenues. One of the key controls built into the design of these incentives is that the company must spend the funds first before receiving any tax incentives. This also helps guard against government funding of research and development that the marketplace would not support otherwise.

32.18 Provincial incentives. Several of the provinces have additional tax incentives for research and development. In most cases these incentives are deducted from the base on which the federal incentives are calculated.

Take–up of the investment tax credits

32.19 Exhibits 32.3 and 32.4 provide information on the level of take–up of the investment tax credits for scientific research and experimental development. Taxpayers who carry out qualifying activities and incur eligible costs can claim investment tax credits. These investment tax credits can be deducted from income taxes otherwise payable. Canadian–controlled private corporations can also receive cash refunds of investment tax credits claimed that cannot be deducted from taxes otherwise payable, if they meet certain criteria. In all other situations, investment tax credits claimed that cannot be deducted can be carried forward 10 years or back three years to be deducted from the taxes payable in those years.

32.20 As can be seen from Exhibit 32.3, Canadian–controlled private corporations (CCPCs) steadily increased the investment tax credits they claimed between 1988 and 1992. As well, the number of CCPCs claiming credits rose from just over 4,000 in 1988 to 5,500 in 1992. The exhibit reveals that the dollar amount of investment tax credits deducted by these corporations has remained relatively stable over the period. The exhibit also shows that the amount refunded to these corporations has increased steadily, reaching $250 million in 1992. In other words, many of these corporations were not able to deduct any or all of the credits they claimed in a particular year, often because they were not in a taxable position. However, they were eligible for a cash refund of those credits.

32.21 Exhibit 32.4 shows the situation for corporations other than CCPCs, such as public companies. The number of those corporations claiming investment tax credits remained quite stable over the five years, at about 1,000. Again, the amounts claimed increased between 1988 and 1992, exceeding $750 million in 1992. However, the amounts deducted from income taxes otherwise payable have remained relatively stable. For those corporations, investment tax credits claimed but not deducted can be carried forward or backward. Revenue Canada's data base shows that, at the end of 1992, corporations claiming scientific research and experimental development tax credits were carrying forward over $2.5 billion of these and other investment tax credits. Some portion of these credits will likely be deducted from income taxes in future years.

Audit Objectives, Scope and Criteria

32.22 The purpose of this audit was to examine, assess and report on how well the tax incentives for scientific research and experimental development are being

delivered, monitored and evaluated. We were particularly interested in learning how the Department of Finance assesses, analyzes and reports on the results being achieved with the incentives.

32.23 We focussed on the investment tax credit portion of the incentives. We conducted our audit work in the Department of Finance and in Revenue Canada's head office and five district offices.

32.24 The audit criteria we used are set out in Exhibit 32.5.

Observations and Recommendations

Department of Finance

Department's role and responsibilities

32.25 The Department's Tax Policy Branch analyzes and makes recommendations on tax policy and legislation. With respect to the tax incentives for research and development, the Branch is responsible for developing, monitoring and evaluating incentives that will meet government objectives.

Costs of the incentives in revenue foregone are open–ended

32.26 In common with most tax provisions, the tax incentives for scientific research and experimental development are demand–driven. Every taxpayer who complies with the incentive provisions in the *Income Tax Act* is entitled to the benefits. But the total amount of tax revenue foregone (the "cost" of the incentives) depends on how taxpayers respond. Low levels of eligible spending by taxpayers result in low costs. High levels of spending by taxpayers result in high costs. The tax credits cannot be withheld by the government simply because the amount of tax revenue foregone has exceeded the amount originally forecast.

32.27 Think of the investment tax credit for scientific research and experimental development in terms of a direct spending program. Suppose the government agrees to pay all those who carry out qualified research and development 20 percent of their costs. There are no spending limits — all who qualify, no matter how much they spend, get a cheque from the government for 20 percent of their eligible costs. The investment tax credit for scientific research and experimental development works in a similar way for all taxpayers who can deduct the credit from taxes payable and for those who receive refunds of their credits.

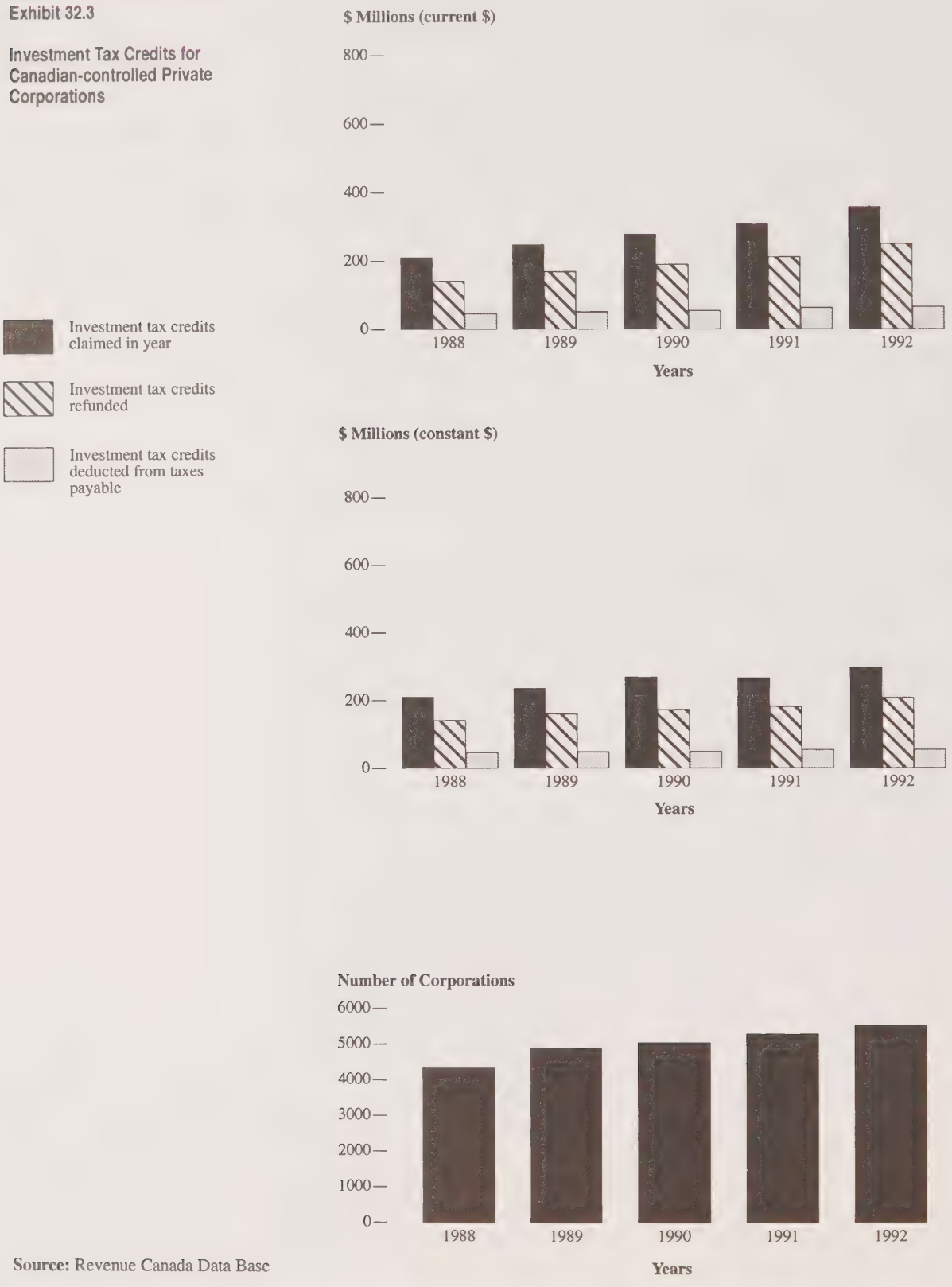
Every taxpayer who complies with the incentive provisions in the *Income Tax Act* is entitled to the benefits.

32.28 For other taxpayers, there are restrictions on the amount of investment tax credits that can be used in a particular year and, therefore, limitations on the cost of the incentives. For example, until 1993 there were limitations on the amount of investment tax credits that could be deducted from taxes otherwise payable in a particular year. Any amount not deducted could be carried forward or backward.

32.29 As noted in Exhibits 32.3 and 32.4, there has been a steady growth in the dollar amount of investment tax credits for scientific research and experimental development claimed over the past five years. In 1992, companies claimed over $1 billion in investment tax credits. Of this amount, approximately $470 million was deducted from income taxes otherwise payable and about $250 million was refunded to taxpayers. The balance was carried forward to future years or back to prior years. As of 30 June 1994, Revenue Canada had over $1.2 billion of investment tax credits in claims where the

Exhibit 32.3

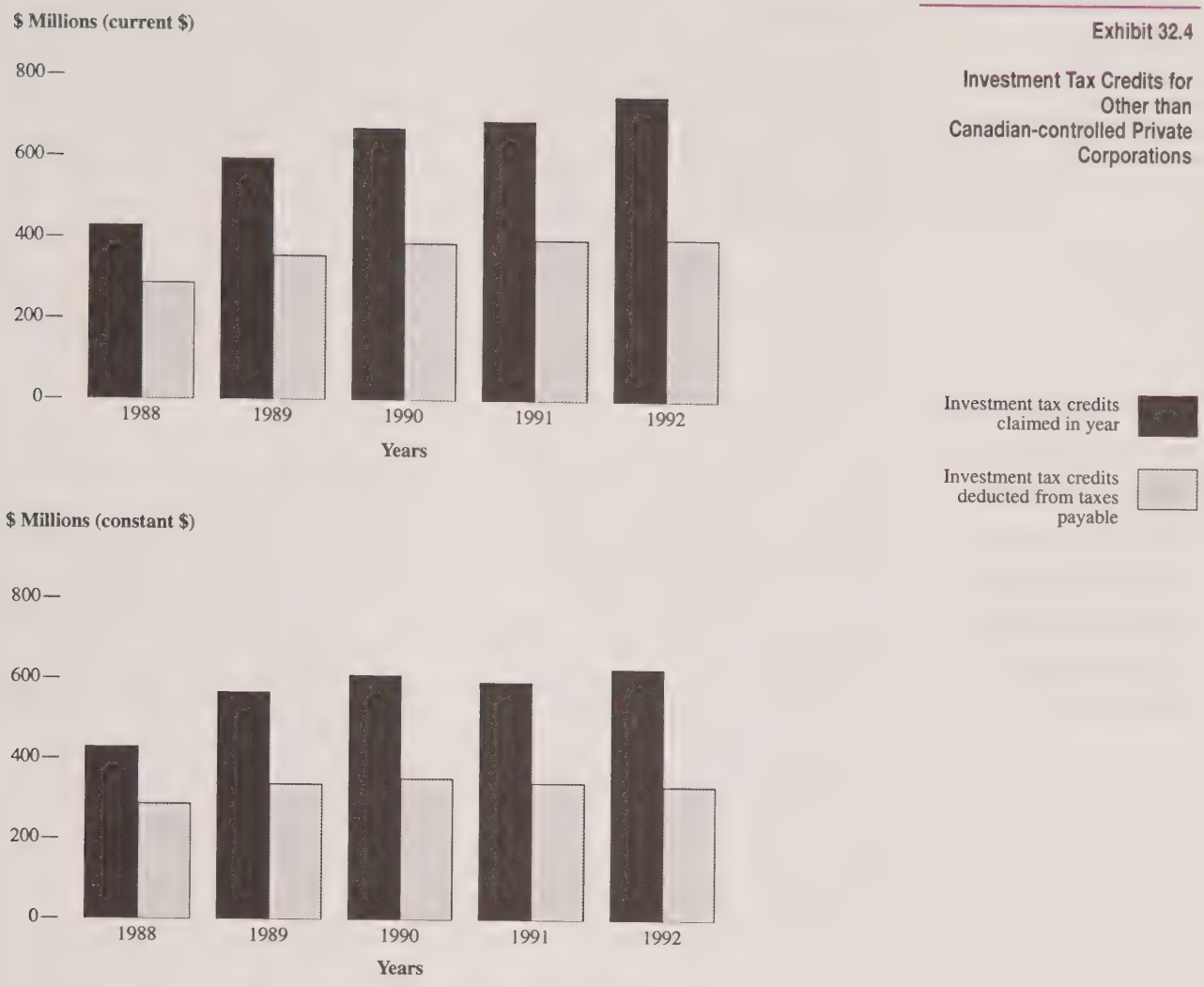
Investment Tax Credits for Canadian-controlled Private Corporations



Source: Revenue Canada Data Base

Exhibit 32.4

Investment Tax Credits for Other than Canadian-controlled Private Corporations



Source: Revenue Canada Data Base

review had not been completed. As long as the taxpayers making these claims do so within a specified time period and qualify for the credits, they will receive them. We also note that, of the $4.4 billion in investment tax credits claimed during the 1988 to 1992 period, $1 billion was claimed by less than one percent of the companies making claims. We note this not to suggest that there is a problem with the claims, but to illustrate that there are no explicit limits on the amount that one company can claim.

In recent years, many taxpayers have refiled their tax returns for prior years to claim investment tax credits for scientific research and experimental development.

32.30 In addition, the design of the tax system means that the government does not know exactly how much will be claimed until it receives a tax return — up to 30 months after the eligible expenditures are actually incurred. To suggest that companies provide information to the government ahead of time would be unrealistic. It would be contrary to one of the advantages of using the tax system to deliver programs — administrative ease and efficiency. However, as pointed out above, all taxpayers who make claims within a specified time period and who qualify for the credits will receive them.

32.31 The demand–driven nature of the incentives and the time lag until the government knows how much has been claimed are characteristics that are common to most tax provisions. However, they could result in high amounts of revenue foregone. They could also make it difficult for Finance to forecast, for budget purposes, how much revenue will be foregone in the future.

32.32 In our view, ongoing and thorough monitoring of the incentives is required to properly manage them. As discussed in paragraphs 32.41 to 32.45, we believe Finance needs to strengthen its monitoring activities.

Taxpayer–requested adjustments have resulted in large costs

32.33 Many taxpayers learned about the incentives for scientific research and experimental development only in recent years and realized that they had been carrying out qualified activities in prior years but had not filed a claim. They have refiled their tax returns, for those prior years that are not statute–barred, to claim the investment tax credits for scientific research and experimental development. These refilings are referred to as taxpayer–requested adjustments. Furthermore, some of the activities were carried out in taxation years that are now statute–barred. In those cases, taxpayers have used the carry–forward provisions for the investment tax credits to carry the

Exhibit 32.5

Audit Criteria

- The objectives of the incentives should be clearly stated.
- Appropriate terms and conditions for receiving the incentives should be established consistent with the legislative mandate.
- Information on the incentives, and particularly information on the rules governing eligibility, guidelines for applicants and the preparation of returns, should be made available to potential recipients.
- Procedures should be established for ensuring that claims approved meet the established terms and conditions for the incentives. These procedures should be documented.
- The management information system should provide reliable, relevant and timely information to the appropriate managers on operations and claims. Managers should monitor the incentives.
- Effectiveness of the incentives should be measured and reported using state-of-the-art and cost–justified procedures. The results of effectiveness measurement should be considered in making decisions about the design and operation of the incentives.

credits forward to a year that is not statute–barred. For example, a company learns in 1994 that it had been carrying out qualified activities in 1988 but had made no claim for investment tax credits in that year; that year is now statute–barred. Under the *Income Tax Act*, the company can calculate the investment tax credits that it would have claimed and then carry them forward to be deducted against taxes paid in a year that is not statute–barred, such as 1992.

32.34 Consistent with regular assessing practices, taxpayers are also entitled to receive interest on approved claims. For example, a taxpayer files a claim in 1994 for scientific research and experimental development expenditures incurred in 1990 and requests that the related investment tax credit be deducted from the income taxes paid in 1990. This will result in a refund to the taxpayer equal to the investment tax credit plus interest. In accordance with the *Income Tax Act*, interest is calculated from 1990 rather than from the date the claim was filed in 1994. This applies to all taxpayers except those who are eligible for cash refunds of investment tax credits. They receive interest only from the date the claim was made.

32.35 Several companies in one particular sector recently filed taxpayer–requested adjustments for scientific research and experimental development expenditures made in years back to 1986. These claims totalled over $300 million in investment tax credits. The research and development claimed was in the field of computer software. Our discussions with technical experts at Revenue Canada who had been assigned to review the claims indicated that most of the activities claimed are, or may be, qualified scientific research and experimental development under the Income Tax Regulations.

32.36 It is important to note that under the rules that existed prior to the 1994 Budget, taxpayers who carried out qualifying scientific research and experimental development activities were entitled to the incentives.

32.37 The February 1994 Budget proposed changes restricting expenditures that qualify for the tax credits to those that the taxpayer identifies no later than 18 months after the year in which the expenditures were incurred. The Budget states: "The government intends to focus the scientific research and experimental development tax incentive on encouraging new research and development rather than on providing an incentive to reopen the calculation of tax credits for expenditures made in prior years." The change will also enable Finance to monitor the costs of the incentives more closely. A transitional provision was included for expenditures incurred in taxation years ending before the Budget date. Taxpayers were given up to 90 days after royal assent to identify the expenditures. This provision received royal assent on 15 June 1994 and so the final date for filing claims relating to previous taxation years was 13 September 1994.

When the government makes changes to a tax provision it cannot necessarily make them effective immediately; it can therefore incur transitional costs in foregone revenue.

32.38 Exhibit 32.6 shows the taxpayer–requested adjustments assessed up to 31 March 1994. In addition, at that date, Revenue Canada had approximately 2,100 more claims waiting to be reviewed and audited, representing over $425 million in potential investment tax credits.

32.39 Subsequently, Revenue Canada received a large number of additional claims up to the 13 September 1994 filing deadline referred to in paragraph 32.37. At the time this report was written, Revenue Canada had not finished entering

all of those claims in its data base. We note, however, that the Department had recorded over 9,000 claims. The Department informed us that the information in its data base on the dollar amount of investment tax credits relating to those claims was unreliable, because it had to be edited and it represented only the amounts claimed by taxpayers. The claims have to be reviewed and audited and this could result in adjustments to the amounts claimed. However, it appears that the dollar amount of investment tax credits relating to the claims is likely to be significant.

32.40 When the government makes changes to a tax provision it cannot necessarily make them effective immediately; it can therefore incur transitional costs in foregone revenue. Taxpayer–requested adjustments for investment tax credits related to scientific research and experimental development have likely resulted in significant transitional costs. In our view, better monitoring of the situation by Finance and an earlier determination that changes were needed could have resulted in fewer claims and lower transitional costs.

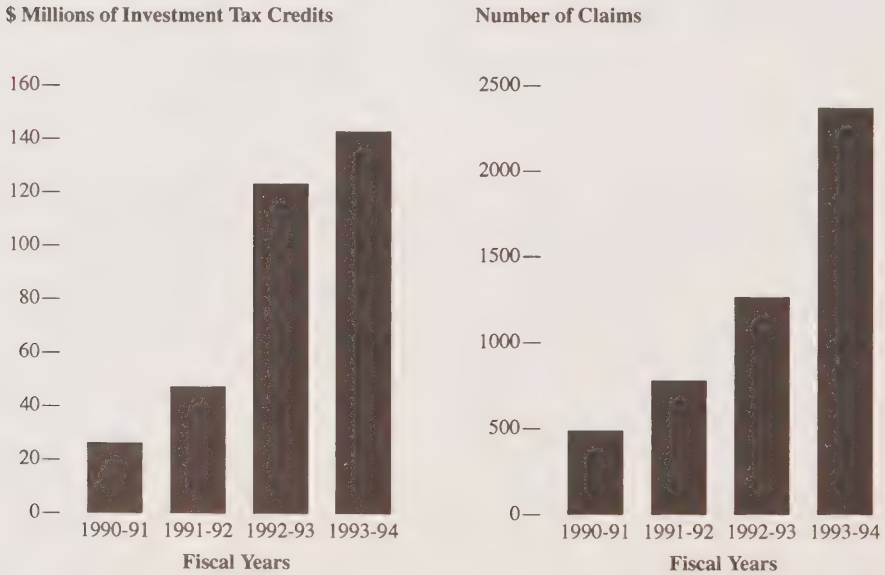
Monitoring needs to be strengthened

32.41 The division of responsibilities between Finance and Revenue Canada has caused some difficulties in monitoring the tax incentives for research and development. Revenue Canada has the main responsibility for administering the incentives and has the most direct contact with the users. However, Revenue Canada is primarily involved with ensuring compliance with the *Income Tax Act*, and approves all claims that comply with the definitions and rules set out in the Act. It is the responsibility of Finance to ensure that the definitions and rules specify qualifying activities and eligible costs that will achieve the government's objectives. But Finance is not involved in the day–to–day administration of the incentives and depends on Revenue Canada to supply it with information to assist in its monitoring activities.

32.42 Ongoing and thorough monitoring of the tax incentives for research and development is needed to

Exhibit 32.6

Taxpayer–requested Adjustments Assessed to 31 March 1994



Source: Revenue Canada

control their costs in foregone revenue and to ensure that the types of activities that qualify under the definitions and rules are those that the government intends to encourage.

32.43 We found that, until recently, Finance has not been monitoring these incentives on a systematic basis, partly because of the data collection problems outlined in paragraphs 32.74 to 32.78. With respect to costs, Finance has been monitoring the investment tax credits originally claimed by taxpayers. It has also been monitoring, to a lesser extent, the credits assessed by Revenue Canada and whether the assessed credits were deducted from taxes, refunded or carried forward. Finance has not made projections of expected costs for comparison with actual costs. The information Finance has on types of activities is mostly anecdotal, based mainly on discussions with Revenue Canada and the public consultations that were conducted during 1992.

32.44 The information needed to monitor the incentives adequately would include data on such things as eligible expenditures incurred, by type of activity qualifying under the definitions and rules and by industry sector; amount of investment tax credits claimed, deducted from tax, refunded, carried back or forward; the number of taxpayers in each of these categories; the type, number and value of audit and appeal adjustments; and the costs to administer the incentives. To supplement these data, particularly on the types of activities that qualify, we believe it would be beneficial for officials from Finance to interact more directly with Revenue Canada's scientists and auditors.

32.45 The Department of Finance should monitor the tax incentives for scientific research and experimental development more thoroughly and systematically and should develop projections of revenue foregone for comparison with the actual amounts.

Department's Response: *Investment tax credits for scientific research and experimental development (SR&ED) are provided in recognition of the fact that the benefits of SR&ED accrue beyond the SR&ED performer to other participants in the economy. These credits are intended to encourage firms to perform SR&ED in Canada and are important given the key role of SR&ED in the emerging new economy. The current system of tax credits for SR&ED provides significant income tax relief.*

The importance of SR&ED for the Canadian economy and the cost of SR&ED tax credits necessitate that timely, accurate and useful information be available to monitor and evaluate the performance of federal income tax incentives for SR&ED. In conjunction with Revenue Canada, we have taken steps to ensure that the information available on SR&ED tax incentives meets these requirements. We will also continue to review our ability to monitor these incentives in an effective manner, and will move expeditiously to complete our evaluation studies of income tax assistance to SR&ED and publish the results.

We found that, until recently, Finance has not been monitoring these incentives on a systematic basis.

No evaluation has been done to determine the impacts and effects of the incentives

32.46 Tax expenditures, like direct expenditures, need to be evaluated periodically to determine their impacts and effects, to assess whether their objectives are being met economically and efficiently, and to determine whether there is a continuing need for them. At the time of our audit, no formal evaluation of the tax incentives for research and development had been done.

The Department of Finance and Revenue Canada have plans to evaluate jointly the research and development tax incentives.

32.47 The Department of Finance and Revenue Canada have plans to evaluate jointly the research and development tax incentives. The issues that will be evaluated have been identified. An evaluation plan is being developed for presentation to and approval by the Department of Finance's Tax Evaluation Advisory Committee.

32.48 We have reviewed the potential evaluation issues identified by Finance. In our view, they address important issues related to the tax incentives.

32.49 We are encouraged by the fact that Finance is now moving to evaluate the tax incentives for scientific research and experimental development but we are concerned that it has taken over 10 years to start such an evaluation. These are expensive incentives and, especially in a time of fiscal restraint, it is important to know whether they are achieving their objectives and whether they are still needed.

Information to Parliament is inadequate

It is important that Parliament hold the government to account for this spending through the tax system.

32.50 In many ways, tax expenditures are not different from direct expenditures. They represent a transfer of funds from all taxpayers to those taxpayers who are performing a desired activity, in this case scientific research and experimental development. Every dollar of investment tax credits allowed to one company must be paid for by all other taxpayers. Seen in this light, it is important that Parliament hold the government to account for this spending through the tax system.

32.51 In order to do this, Parliament needs information: it needs to know what the tax incentives for research and development are expected to accomplish, how much they are expected to cost, what they actually have accomplished and what they actually cost. It is important that this information be available at the same time as the Estimates and Public Accounts are being considered so Parliament can get a full picture of planned and actual government spending in support of research and development.

32.52 Finance's Part III for 1994–95 is silent on its responsibilities for the operational and financial aspects and the results of the tax incentives for research and development. We believe that Finance needs to include in an accountability document, such as its Part III or the tax expenditure report, an overview of the tax incentives for research and development, and references to where more detailed information can be found. At a minimum, this information would include a description of the incentives, their objectives, their expected costs and their actual costs. As well, information about actual results would be desirable.

32.53 Information provided. Parliament received a paper for consultation in 1983 on research and development tax policies. That paper reviewed the incentives for research and development that existed at the time and proposed changes to those incentives. The paper contained some information on expected results and expected costs. Since then there have been references to the research and development tax incentives in budget documents when changes were being proposed. The information provided generally described the changes being made and the rationale for them.

32.54 The tax expenditure report published in 1993 (the previous one containing corporate data was published in 1985) gave amounts of revenue foregone for the years 1989 and 1990. However, it did not provide any comparison of actual revenue foregone to projections, or any

information on what had been accomplished.

32.55 In our view, this information is not sufficient to allow Parliament to exercise its oversight role or to hold the government accountable for its spending through the tax system on the tax incentives for research and development. This conclusion is echoed in Chapter 9, which says that current reports do not provide parliamentarians with the information they need to assess whether the government's investment in science and technology reflects Canadians' needs and opportunities.

32.56 The Department of Finance should improve its accounting for the tax incentives for scientific research and experimental development by providing consolidated information on the projected costs and actual costs and the results, in any regularly published accountability document such as Part III of the Estimates or the tax expenditure report.

Department's response: *As indicated in our response to the recommendation in paragraph 32.45, we will continue to review our ability to monitor these incentives in an effective manner. At this time, focussing efforts on improved monitoring is a more effective use of the Department's limited resources than projecting estimates and comparing them to actual tax expenditures.*

Revenue Canada

Department's responsibilities and administrative organization

32.57 Revenue Canada's mandate is to administer the *Income Tax Act* and other Acts. With respect to the tax incentives for research and development, the Department is responsible for ensuring that all claims by taxpayers for incentives comply with the rules set out in the Act and in the Income Tax Regulations. To help accomplish this, Revenue Canada provides information and assistance to taxpayers in a number of different ways. The Department also promotes the incentives.

32.58 Within Revenue Canada, the Verification, Enforcement and Compliance Research Branch has overall responsibility for administering the incentives. A small group at head office develops guidelines and monitors the work done in the district offices across the country.

New approaches taken to deliver the incentives

32.59 One of the first steps Revenue Canada took in delivering these incentives was to recognize that its auditors were not trained to make decisions on whether a particular activity was scientific research or experimental development as defined in the Income Tax Regulations. It therefore hired science advisors with industrial research and development experience who were able to make such judgments. Currently, the Department has over 60 such science advisors on staff. In addition, it hires experts on a contract basis, as necessary, to supplement its in–house expertise. Claims are reviewed by a science advisor for the technical aspects and by an auditor for the related costs. The activities undertaken by the taxpayer must first qualify under the Income Tax Regulations before the costs can be considered.

Claims are reviewed by a science advisor for the technical aspects and by an auditor for the related costs.

32.60 Another step was to raise public awareness about the incentives. Public seminars were organized to inform taxpayers about the incentives and how to apply for them. Both science advisors and auditors participated in these seminars. Departmental statistics indicate that during the period 1 April 1993 to

Public seminars were organized to inform taxpayers about the incentives and how to apply for them.

31 March 1994, there were 205 seminars held with over 5,500 participants.

32.61 A third step was to publish information about the program. There is an Interpretation Bulletin, an Information Circular, a guide to the claim form and several promotional brochures. In addition to the Information Circular, which sets out in general terms what qualifies as scientific research and experimental development under the *Income Tax Act*, six industry papers have been published. These papers give practical indicators of which activities in a particular industry would and would not qualify.

32.62 The Department has also consulted with the user community on an ongoing basis. It used participants from industry to help write the papers referred to above, as well as other interpretive documents. Also, a committee of industrial users advises the Deputy Minister on issues related to the Department's administration of the incentives.

It is important that all claims be subjected to some minimum verification to determine whether the activities undertaken qualify and whether the costs of those activities are eligible.

32.63 These steps have meant a cultural shift for many employees of the Department, particularly its auditors. In the past, auditors have tended to focus on issues of non–compliance with the *Income Tax Act*, which frequently lead to increased tax revenues. With the tax incentives for research and development, science advisors and auditors are encouraged, within the confines of the *Income Tax Act*, to inform potential claimants about the incentives and to ensure that all claimants receive their full entitlements.

Revenue Canada's review process has changed

32.64 The Department's process for reviewing claims for investment tax credits related to scientific research and experimental development has changed several times in recent years. In our view, these changes represent improvements. Ordinarily, the Department assesses returns when they are filed based on the information provided in the return, and relies on subsequent audits to verify that information.

32.65 With the investment tax credits for scientific research and experimental development, that process is modified. Until 1993, some claims, mainly those requesting a refund, were audited before they were assessed. Others, however, were assessed in the regular way and often had to wait several years to be audited. Some were never audited.

32.66 Now all claims are subjected to a desk review by a science advisor and an auditor when they are filed. This review is designed to determine whether the activities being claimed meet basic eligibility requirements and whether the costs are reasonable. Revenue Canada is committed to reporting the results of the review to the taxpayer within 120 days of receiving a complete claim. As a result of the desk review, the claim either is accepted as filed or is audited. If the claim is accepted, the taxpayer will receive a letter confirming this and explaining that no audit of the claim will be done in the future, in normal circumstances. If an audit is required, the Department is committed to conducting it within 120 days for claims requesting a refund or within one year for other claims, unless the taxpayer requests otherwise. This new process is designed to give taxpayers certitude as early as possible about the status of their claims.

32.67 We believe this change is a positive step and has a further benefit. In our view, a dollar of tax revenue intentionally foregone is much the same as

a dollar spent. Therefore, it is important that all claims be subjected to some minimum verification to determine whether the activities undertaken qualify and whether the costs of those activities are eligible. Claims that do not pass this test can then be audited. We are encouraged that Revenue Canada is now subjecting all claims to some minimum verification.

High numbers of claims are putting pressure on Revenue Canada

32.68 As indicated in paragraphs 32.33 to 32.40, there has been a large increase in the number of taxpayer–requested adjustments received by Revenue Canada over the past few years. As well, the Department's statistics show that the number of annual claims is increasing. Furthermore, as discussed above, the Department is now reviewing all claims when they are filed and is committed to notifying the taxpayer about the results of the review within 120 days of receiving a complete claim.

32.69 This increased workload is putting pressure on Revenue Canada's ability to administer the incentives in a timely and consistent manner, one of its main objectives. Resources allocated to administering the incentives were increased in 1993–94 but are expected to remain the same for 1994–95.

32.70 Revenue Canada has taken steps to manage this situation. All taxpayer–requested adjustments are exempt from the 120–day guideline, although employees are still expected to process them as expeditiously as possible. As well, the changes in the *Income Tax Act* relating to taxpayer–requested adjustments mean that the intake of such claims should be significantly reduced after 13 September 1994.

32.71 The Department found in the past that it often spent more time reviewing the first claim that a taxpayer submitted than it spent on subsequent claims. It now provides a service to first–time claimants to help them with their first claim, with a view to reducing the time it spends reviewing them.

32.72 The decentralized way in which the incentives are administered means that the Department needs to be concerned about consistency in interpreting and applying the rules. The Department has strengthened its review mechanism to help deal with this concern.

32.73 Given the increasing workload that Revenue Canada is facing with these tax incentives, coupled with the increasing complexity of some of the claims, it will have to remain vigilant to ensure that the incentives are administered in a timely and consistent manner.

Revenue Canada will have to remain vigilant to ensure that the incentives are administered in a timely and consistent manner.

Data collection needs to be strengthened

32.74 Revenue Canada has been collecting some, but not all, of the information needed to monitor the incentives. The information is needed by Revenue Canada to monitor its administration of the incentives, and by Finance to monitor the costs and whether the types of activities that qualify under the definitions and rules are those that the government intends to encourage.

32.75 We expected to find information on how much was being claimed, deducted, refunded, carried back or forward; the number of taxpayers in each of these categories; the amount of eligible expenditures incurred, by type of activity qualifying under the definitions and rules and by industry sector; the level of audit coverage; and the type, number and value of audit and appeal adjustments.

32.76 We found information on how much was being claimed, the number of

taxpayers involved, and the number and value of audit adjustments. In our view, this is not sufficient to allow Revenue Canada to monitor its administration of the incentives effectively or to allow it to make strategic decisions about where to focus future efforts. Nor is it sufficient to allow Finance to carry out its monitoring activities.

32.77 Moreover, Revenue Canada discovered in 1993 that one of its key data bases for the information it was collecting was not completely reliable. The Department has an action plan to improve the quality and reliability of the data base and is working on it.

Revenue Canada discovered in 1993 that one of its key data bases for the information it was collecting was not completely reliable.

32.78 Revenue Canada, in consultation with the Department of Finance, should determine and collect the information needed to monitor fully and to report on the tax incentives for scientific research and experimental development.

Department's response: *Consistent with the Department's action plan, the quality and reliability of the data base will continue to improve.*

The Department introduced a verification process for the SR&ED form (T661) on 1 October 1993 and is completing the enhancement of existing information management systems to capture accurate and detailed information on SR&ED claims that will further assist in monitoring and evaluating the SR&ED program.

Discussions with the Department of Finance have been held to ensure that, in part, the needs of both departments are met with regard to the quantity and quality of information necessary for the monitoring and evaluation of the SR&ED program. As a result, an interdepartmental committee has been formed that will meet on a regular basis to address these issues.

Conclusion

Many 1986 observations persist

32.79 In our 1986 chapter on income tax expenditures, we concluded that the Department of Finance was not adequately managing tax–delivered programs. We called for improved monitoring, evaluation and reporting of tax expenditures. Our present observations and conclusions on the tax incentives for scientific research and experimental development are much the same.

32.80 While some progress has been made on monitoring these tax incentives, much remains to be done in order for the Department of Finance and Revenue Canada to control them. Similarly, the planned evaluation (which in our view is overdue) should point out the impacts and effects of the incentives and determine whether they are still needed. Finally, while recognizing the progress that has been made, we stress the need for better reporting on these tax incentives. It is difficult, if not impossible, for Parliament to hold the government accountable for this spending through the tax system when it does not have proper information. In a time of fiscal restraint, it is imperative that the Department of Finance ensure that Canadian taxpayers are getting value for money from the tax incentives for scientific research and experimental development.

Chapter 33

Department of Finance and Revenue Canada

Tax Assistance for Retirement Savings

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Department of Finance and Revenue Canada

Tax Assistance for Retirement Savings

Assistant Auditor General: Shahid Minto
Responsible Auditors: Barry Elkin and Michael Adibe

Main Points

33.1 The federal government provides tax assistance for retirement savings (TARS) through the Canadian income tax system. The primary purpose of TARS, as derived from the Department of Finance's publications, is to encourage Canadians to save for their retirement. Another objective is to ease financial pressure on public pension and social security programs. The government has estimated that the amount of deferred tax revenue it did not collect in 1991 because of the TARS program was about $15 billion, or 2.2 percent of gross domestic product. This figure excludes provincial tax expenditures for retirement savings.

33.2 In 1992, approximately 7 million Canadian tax filers received tax assistance for retirement savings as contributors to, or members of, either registered pension plans (RPPs) or registered retirement savings plans (RRSPs), or both. About 5.2 million people and their employers contributed $19.7 billion to RPPs, while about 4.8 million individuals contributed $16 billion to RRSPs. In 1992, withdrawals amounted to $19 billion from RPPs and $4.7 billion from RRSPs, and the assets accumulated in plans were $417 billion.

33.3 Accountability for the costs and results of tax assistance for retirement savings needs to be improved. The Department of Finance needs to state clearly the objectives of the TARS program, and to improve monitoring and reporting of its costs, workings and results annually in order to foster scrutiny and evaluation. It also needs to develop alternative cost estimates to assist policy makers in assessing the long–term fiscal implications of TARS. The Department should ensure that its evaluations address key results and other issues of major concern.

33.4 While Revenue Canada has adequate procedures for reviewing and approving contributions to defined benefit plans and for verifying pension adjustments, its monitoring of registered plans' compliance with the *Income Tax Act* needs to be strengthened. The current compliance strategy needs to be reviewed and revised, as appropriate. The Department needs to develop, keep, report and use summary information on the nature, extent and revenue implications of identified non–compliance. It needs to document compliance profiles for registered plans. It also needs to increase the level of audit coverage of registered plans, and implement procedures to verify RRSP contributions, transfers between plans, and transactions of deferred profit sharing plans. Finally, in collaboration with the Department of Finance, Revenue Canada needs to establish effective penalties for cases of non–compliance where revocation of registration is considered inappropriate.

33.5 Both Finance and Revenue Canada need to improve the information provided to Parliament on TARS. We are concerned about inadequate documentation to support the cost estimates that Finance provided to a parliamentary committee in 1990. Finance needs to ensure that the results of its evaluation studies are provided to Parliament.

Introduction

Using the tax system to provide assistance

33.6 There are many ways for the government to achieve its social and economic objectives. The most visible is direct government spending on programs, grants and subsidies. The government also pursues its policy objectives through measures (such as tax deductions, credits, exclusions and income tax deferrals) contained in the income tax system. Because those measures represent alternative forms of government assistance, with financial implications similar to those of direct expenditures, they are generally referred to as tax expenditures.

Tax assistance for retirement savings costs the federal government about $15 billion annually in deferred tax revenue

33.7 The federal government provides tax assistance for retirement savings (TARS) through the Canadian income tax system. The Department of Finance has not articulated the specific objectives of TARS in any single document. The primary purpose of TARS, as derived from various departmental publications, is to encourage Canadians to save for their retirement and enable them to avoid serious disruption in their standard of living upon retirement. Another objective is to ease financial pressure on public pension and social security programs. Other objectives of TARS implied in Finance's publications include helping to expand the pool of domestic savings for capital investment and strengthening the private pension sector.

33.8 The TARS program is delivered through deferral of tax on savings in four types of plans that are registered by Revenue Canada: registered pension plans (RPPs), registered retirement savings plans (RRSPs), deferred profit sharing plans (DPSPs) and registered retirement income funds (RRIFs). Tax assistance for retirement savings is provided through provisions of the *Income Tax Act* that make contributions to these plans by individuals and employers deductible from taxable income, within defined limits. The investment earnings on assets in the plans are also tax–exempt until funds are withdrawn from the plans, but funds withdrawn from the plans are taxed. Individuals benefit because the tax on money contributed to the plans and accumulating in them is deferred until that money is withdrawn from the plans.

33.9 Tax assistance for retirement savings is a long–standing feature of the Canadian income tax system. Over the years, related tax legislation and regulations have undergone many revisions. The changes culminated in 1990 with the passage of Bill C–52, an Act that amended the *Income Tax Act* and brought in a uniform, comprehensive system of limits for all types of pension and retirement savings plans (see Exhibit 33.1 for historical background).

33.10 A key objective of that reform was to correct serious inequities in the system, which provided taxpayers at the same level of earned income with quite different opportunities to save for retirement. As reported by the Department of Finance, those inequities left many Canadians without adequate opportunities to build tax–assisted pensions, while others could obtain excessive tax benefits. The aim of the reform was to provide all Canadians at the same level of earned income with equal opportunities to provide for their retirement, regardless of the type of

The federal government provides tax assistance to encourage Canadians to save for their retirement and to ease financial pressure on public pension and social security programs.

Exhibit 33.1

Historical Developments

1870	Superannuation plans for federal government employees established.
1909	Introduction of government annuities.
1917	Personal income tax introduced.
1919	Deductibility of employee contributions to employer–sponsored plans introduced.
1938	Deductibility of employer contributions to employer–sponsored plans introduced.
1939	Significant spread of private sector pension plans.
1947	Revenue Canada instituted administrative rules to limit pension benefits from employer–sponsored plans to forestall their being used to circumvent wage controls.
1957	RRSPs introduced to deal with unfairness to, and encourage saving by, self–employed individuals and those without access to employer–sponsored RPPs.
1961	Parallel tax treatment for RPPs and RRSPs extended to DPSPs.
1966	Commencement of Canada/Quebec Pension Plans.
1966	Carter Commission on Taxation recommended the introduction of comprehensive lifetime limits on tax–assisted retirement savings and raised concerns about affordability.
1972	Allowable contribution limits to RPPs and RRSPs increased.
1976	System of limits on tax–assisted saving revised; limits to RPPs and RRSPs further increased.
1979	Special Senate Committee on Retirement Age Policies concluded that CPP/QPP should be the principal vehicle for reforming the Canadian pension system. Also recognized the serious shortcomings of the private pension plan system with respect to coverage, benefits, vesting, portability and indexing, as well as in its treatment of particular groups such as women and part–time workers.
1980	Finance task force *The Retirement Income System in Canada: Problems and Alternative Policies for Reform* (the Lazar Report) examined the problems and alternative policies for reform; noted three major difficulties with tax–assisted supplementary programs – their level, their inflexibility and the variation among those in similar circumstances in access to tax deductibility allowed.
1981	National Pension Conference.
1982	Federal Green Paper *Better Pensions for Canadians* dealt with inequities and reform.
1983	*Report of the Parliamentary Task Force on Pension Reform* (the Frith Committee) reviewed the 1982 proposals; revisited, cited and recommended approach used in Carter Commission.
1984	Finance issued *Building Better Pensions for Canadians*.
1985	Budget papers included alternative proposals for pension reforms.
1986	White Paper on *Savings for Retirement* and Finance publication *Savings for Retirement – Improved Tax Treatment: Detailed Procedures* issued.
1988	Draft legislation, explanatory notes and detailed rules on pensions prepared.
1989	Bill C–52 tabled to amend the *Income Tax Act* to implement a revised system of tax assistance for retirement savings.
1990	Bill C–52 passed; foreign investment limit raised.
1991	Bill C–52 came into effect.
1992	Higher contributory limits deferred.

retirement savings plan they participate in, and whether they are employed or self–employed.

33.11 The government has estimated that the amount of deferred federal tax revenue it did not collect in 1991 because of the TARS program was about $15 billion, or 2.2 percent of gross domestic product. This figure excludes provincial tax expenditures for retirement savings.

33.12 Tax assistance for retirement savings is the single largest tax expenditure, and is a major component of Canada's retirement income system. It represented over 30 percent of federal direct expenditures and tax expenditures on retirement income security programs in 1991 (see Exhibits 33.2 and 33.3).

33.13 In 1992, approximately 7 million Canadian tax filers received tax assistance for retirement savings as contributors to, or members of, either RPPs or RRSPs, or both. About 5.2 million people (38 percent of the labour force or 47 percent of paid employees) and their employers on their behalf contributed $19.7 billion to registered pension plans, while about 4.8 million individuals (26 percent of all tax filers) contributed $16 billion to registered retirement savings plans. In 1992, withdrawals amounted to $19 billion from RPPs and $4.7 billion from RRSPs. The assets accumulated in those plans, including assets and reserves held by insurance companies for pension plans, amounted to $417 billion: $270 billion in RPPs and $147 billion in RRSPs. These exclude some assets in self–directed RRSPs, such as investments in bonds and stocks.

33.14 Canada's system of tax assistance for retirement savings is similar to those of other countries in the Organization for Economic Co–operation and Development (OECD), notably France and the United Kingdom. However, the Canadian pension system differs from most OECD countries in the strong role it gives to individual retirement savings arrangements. As well, Canada's system is unique in the way it integrates contribution limits for all types of pension and retirement savings plans (see Exhibit 33.4).

Why we chose to audit now

33.15 We undertook the audit having considered the following factors:

- the substantial amount of tax expenditures involved;
- Parliament's interest in the program as reflected, for example, in the 1990 recommendation of the House of Commons Standing Committee on Finance that a review of the program be undertaken after the new system (effective January 1991) had been in place for three years, and the Committee's request that Finance study certain issues related to the program and report back before the end of 1990. The Standing Committee on Public Accounts also asked Finance to evaluate the reform of TARS;
- the relative novelty and the complexity of the present regime, which requires an effective compliance strategy to manage the increase in compliance monitoring workload that resulted from the change to the new system; and
- the concerns about the program expressed by some employer groups, the pension industry and others. Those concerns include remaining and new inequities in the system, the results, costs and continued affordability of the program, the burden of compliance cost on plan sponsors, and the substantial and growing use of RRSP funds for purposes other than retirement income.

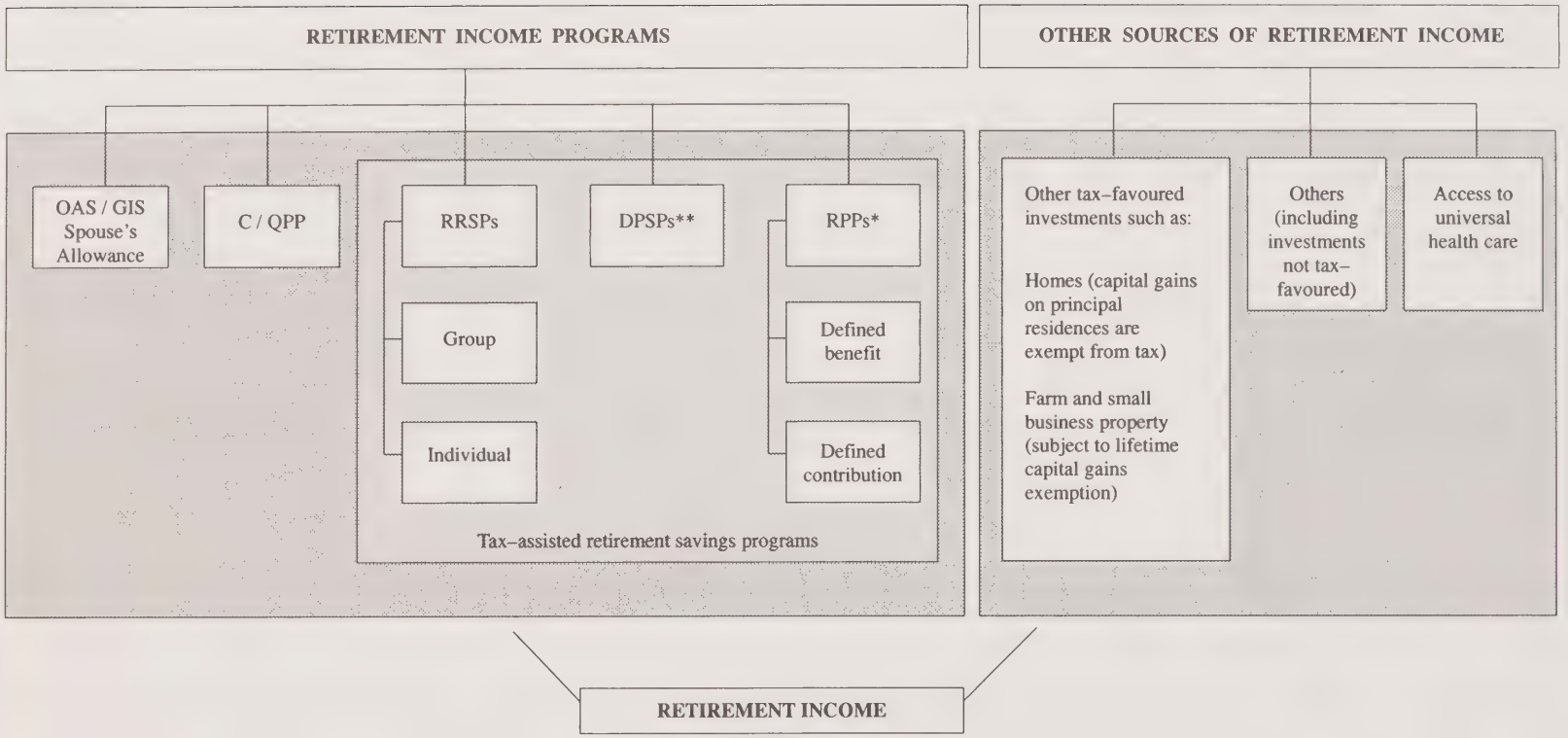
33.16 Although the program of tax assistance for retirement savings

In 1992, approximately 7 million Canadian tax filers received tax assistance for retirement savings.

Exhibit 33.2

Canada's Retirement Income System

Tax assistance for retirement savings is but one component of Canada's retirement income system.



* Employer–sponsored registered pension plans

** Deferred profit sharing plans

contributes to similar objectives as public pension and other retirement income programs, our audit focussed on TARS, not on those other programs (Canada and Quebec Pension Plans, Old Age Security, Guaranteed Income Supplement and Spouses Allowance). Nor did we examine the adequacy of funding of the registered pension plans, which is regulated by the federal and provincial *Pension Benefits Standards Acts*.

33.17 Our audit was directed at Finance and Revenue Canada, the two departments directly involved.

How the report is structured

33.18 Details of our audits are presented in two segments, one on Finance and the other on Revenue Canada. Each segment covers the audit scope and objectives, and the observations and recommendations related to the particular department's responsibilities.

DEPARTMENT OF FINANCE

The Role of the Department of Finance in TARS

33.19 The Department of Finance is responsible for the design and management of the program of tax assistance for retirement savings. Management of the program involves monitoring, evaluating and reporting on its costs and effectiveness, and recommending changes, as appropriate. This responsibility for the substantial TARS program is carried out by a staff of three, with the involvement of other staff when required.

Audit Scope and Objectives

33.20 We audited the program of tax assistance for retirement savings with a view to:

- examining the manner in which Finance monitors, evaluates and reports

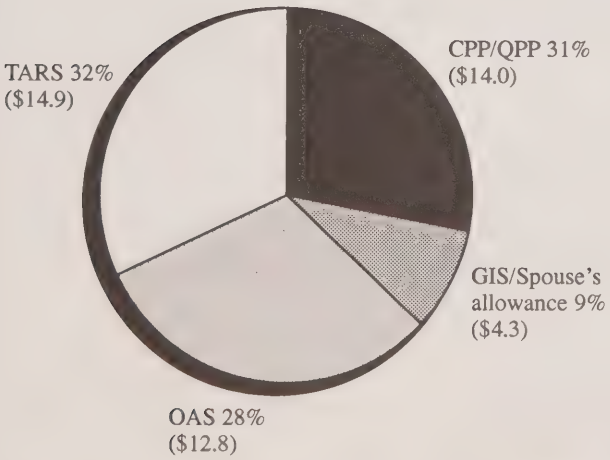


Exhibit 33.3
Expenditures on Retirement Income Security Programs, 1991 (in billions of dollars)

The TARS program represented over 30 percent of federal direct expenditures and tax expenditures on retirement income security programs in 1991.

Sources: Department of Finance, Régie des rentes du Québec and Public Accounts of Canada

Exhibit 33.4

International Comparison of Tax Treatment of Retirement Benefit Programs

COUNTRY	CONTRIBUTIONS	INVESTMENT EARNINGS	BENEFITS
COUNTRIES PROVIDING FULL OR PARTIAL TAX ASSISTANCE			
Australia			
I. Social Security Programs	N/A	N/A	Not Taxable*
II. Employer–sponsored Arrangements	Partially Exempt Employee – Not Exempt	Partially Exempt	Partially Taxable
III. Individual Retirement Savings Arrangements	Partially Exempt	Partially Exempt	Partially Taxable *provided social security is only source of income
Canada			
I. Social Security Programs	Exempt	N/A	Taxable*
II. Employer–sponsored Arrangements	Exempt	Exempt	Taxable
III. Individual Retirement Savings Arrangements	Exempt	Exempt	Taxable * Except for income–tested GIS benefits. OAS also subject to tax clawback.
France			
I. Social Security Programs	Exempt	N/A	Taxable
II. Employer–sponsored Arrangements	Exempt	Exempt	Taxable
III. Individual Retirement Savings Arrangements	Partially Exempt	Exempt	Partially Exempt
Germany			
I. Social Security Programs	Partially Exempt	N/A	Taxable
II. Employer–sponsored Arrangements	Partially Exempt (including book reserves)	Exempt	Partially Taxable
III. Individual Retirement Savings Arrangements	Minimal Exemption	Exempt	Partially Taxable
Italy			
I. Social Security Programs	Exempt	N/A	Taxable
II. Employer–sponsored Arrangements	Partially Exempt	Exempt	Partially Taxable
III. Individual Retirement Savings Arrangements	Partially Exempt	Exempt	Partially Taxable
Japan			
I. Social Security Programs	Exempt	N/A	Partially Taxable
II. Employer–sponsored Arrangements	Exempt	Partially Exempt	Partially Taxable
III. Individual Retirement Savings Arrangements	Exempt	Exempt	Not Taxable
Sweden			
I. Social Security Programs	Exempt	N/A	Taxable
II. Employer–sponsored Arrangements	Partially Exempt	Partially Exempt	Taxable
III. Individual Retirement Savings Arrangements	Partially Exempt	Partially Exempt	Taxable
United Kingdom			
I. Social Security Programs	Employer – Exempt Employee – Not Exempt	N/A	Taxable
II. Employer–sponsored Arrangements	Exempt	Exempt	Partially Taxable
III. Individual Retirement Savings Arrangements	Exempt	Exempt	Partially Taxable
United States			
I. Social Security Programs	Employer – Exempt Employee – Not Exempt	N/A	Taxable
II. Employer–sponsored Arrangements	Employer – Exempt Employee – Exempt under some programs	Exempt	Taxable*
III. Individual Retirement Savings Arrangements	Minimal Exemption	Exempt	Taxable * Except for portion attributable to non–exempt employee contributions
COUNTRIES PROVIDING NO TAX ASSISTANCE			
New Zealand			
I. Social Security Programs	N/A	N/A	Taxable*
II. Employer–sponsored Arrangements	Not Exempt	Not Exempt	Not Taxable
III. Individual Retirement Savings Arrangements	N/A	N/A	N/A *also subject to surtax

Caveat: The levels of contributions and benefits that receive tax assistance vary from country to country. Appropriate comparison would require that maximum and average benefits from all sources be compared to the average wage in each country.

on the results and costs of this significant tax expenditure program; and

- providing objective information to help Parliament scrutinize the costs and results of the program.

33.21 In the course of our audit, certain differences, sometimes bordering on conflicts, between federal and provincial legislation in areas of pension and retirement savings came to our attention. We reviewed steps being taken by Finance to resolve those potential areas of conflict.

Observations and Recommendations

Need for Clear Statement of TARS Objectives

Objectives are not specific enough to allow their achievement to be assessed

33.22 We would expect Finance to clearly specify the objectives and intended results of the TARS program to enable Parliament and the public to assess their relevance and to probe the extent of their achievement.

33.23 There is no compendium statement of objectives for the TARS program at the disposal of the Department of Finance, other policy makers or the public. To identify the objectives, intent and rationale of the program, and the public perception of those objectives, we reviewed many documents, including academic journals and newspaper articles.

33.24 The objectives are not stated clearly. We are concerned that the objectives are not specific enough to allow their achievement to be assessed. Following are two examples that illustrate the reasons for our concern.

33.25 A common objective. Some of the objectives of tax assistance for retirement savings complement those of other retirement income programs — Canada Pension Plan/Quebec Pension Plan, Old Age Security and Guaranteed Income Supplement. For example, the goals of income replacement and of helping Canadians to avoid serious disruption in their standard of living upon retirement are not unique to the TARS program, but are pursued as well by those public pension plans and retirement income security programs and by other tax–favoured investments (capital gains exemption on principal residences). For proper evaluation, it is necessary that the program objectives for TARS clarify its role relative to other retirement income programs.

33.26 As well, because the TARS program is used in combination with other programs to achieve those objectives, evaluation of their achievement needs to be conducted interdepartmentally, for example, with the Department of Human Resources Development. In our 1993 Report we observed that providing parliamentarians with the information they need on the $30 billion spent annually on seniors' pensions and the billions spent on related tax measures would require a sectoral analysis of the programs as a whole.

33.27 The target population is not evident. Public statements of the objectives suggest that the TARS program is available to those with taxable earnings who choose to contribute to plans. However, the target population is unclear. If the target population of the TARS program were specified clearly, it would be easier to assess whether the program indeed benefits that population.

Need for Better Estimates and Reporting of Costs

The cost of tax assistance for retirement savings has not been reported on a regular, consistent and timely basis

33.28 We would expect Finance to make reasonable, reliable and consistent estimates of the costs of the TARS program and to report those estimates on a regular and timely basis.

33.29 Since 1979, Finance has published estimates of tax expenditures for retirement savings intermittently along with estimates of other tax expenditures. This has left large gaps between publication dates: the four years between 1980 and 1985, and the six years between 1985 and 1992. During those periods, no updated estimates of tax expenditures for retirement savings were presented to Parliament or the public.

33.30 As well, the continuity of cost estimates was interrupted because estimates were not calculated for the period 1984 to 1987 but were resumed for the period 1988 to 1991.

33.31 The consistency and comparability of the historical estimates prepared by Finance were affected significantly by a major change in methodology, introduced in 1985. The present series were not linked to the earlier ones, nor were the previous estimates revised using the current methodology to permit comparability and trend analysis.

33.32 The timeliness of Finance's estimates has also not been adequate or consistent. There have been substantial lags in the calculation of estimates, caused partly by delays in the availability of data. Except for the earlier series, estimates have usually been published two or three years after the year to which the latest numbers relate. Thus, estimates for 1979 and 1980 were published in those years, whereas the latest year presented in the 1985 publication was 1983. In the 1992 publication, the latest year was 1989; in the 1993 publication, the latest year was 1991.

Cash–flow cost estimates need to be supplemented with longer–term, present value cost estimates

33.33 Prior to 1985, Finance used an interest value approach to estimate tax expenditures for retirement savings. The approach assumed that the cost was equivalent to an interest–free loan in the amount of the deferred tax outstanding. The cost of TARS for each year was calculated by multiplying the estimated investment income on the assets of the plans by the marginal tax rate of contributors.

33.34 Since 1985, Finance has used an annual cash flow method to estimate the tax expenditure costs for TARS. Beginning with the 1992 *Government of Canada Personal Income Tax Expenditures* report, the basis of the cash flow estimates was revised. The cash flow approach estimates the tax revenue that the government did not collect in a given year because of the TARS provision in the income tax system. The approach has a number of advantages and disadvantages. Among the advantages, the estimates are easier to calculate because past data on contributions, investment income and withdrawals that are used to make the calculations are readily available. The estimates do not require projections of future trends in such variables as interest rate, inflation rate and take–up rates. The estimates are comparable to non–deferral tax expenditure costs. The fiscal impact of the tax expenditure in any specific year is readily discernible; and estimates are

responsive in a specific year to changes in flow variables, such as contribution limits, that have significant impacts on tax revenues.

33.35 The major limitation is that such estimates do not represent the "true cost". They do not reflect the long–term costs of the program, since they account for only the immediate costs of annual contributions, tax deferral of interest earnings of plan assets, and the tax recovered on withdrawals in the current year.

33.36 Another accounting basis that Finance could use to make its cost estimates is the present value (discounted) approach. The advantage of this approach is that all current year and future costs (calculated in constant dollar terms) arising from an activity undertaken in any given year can be provided to help evaluate the long–term impact on tax revenue. One drawback is that the present value approach requires making various discounting assumptions and projections of future flows and parameters, such as the average length of time the contributions will remain in the pension plan, their future earnings rate, the future tax rate and the discount rate. These projections introduce a substantial element of uncertainty into the estimates.

33.37 To assist policy makers in assessing both the current and long–term fiscal implications of the TARS program, Finance needs to develop and publish, in addition to the cash flow estimates, cost estimates based on the present value approach or on some other method that would measure long–term costs or aggregate lifetime costs.

Need to Improve Performance Measurement and Program Evaluation

Performance of the TARS program is not monitored and reported regularly

33.38 Except for occasional presentations – for example, to the Finance Committee in 1990 and to the Minister of Finance in 1994 – and in discussion papers, the Department has not monitored and regularly reported results and other performance indicators for the TARS program. Included in its presentations and discussion papers was information on the use of the program (the number of contributors to plans by income level), amounts of contributions, assets in plans and earnings replacement rates.

33.39 In our opinion, starting with that information, the Department of Finance can develop a set of key performance indicators that it could monitor and report, ideally, on an annual basis. Exhibit 33.5 presents examples of performance indicators that Finance could consider in selecting those for ongoing monitoring and regular reporting. Some of the indicators are already being reported by, or are available from, Revenue Canada and Statistics Canada. We have also developed some questions to aid in developing and refining the indicators and for evaluating the results and impacts of the program. These are presented in Exhibit 33.6.

Monitoring of results needs to be supplemented by periodic evaluations

33.40 Periodic evaluation studies need to be done to determine whether the program is meeting its objectives and to assess its impacts and effects. These studies would also examine the program's

To assist policy makers in assessing the long-term fiscal implications of the TARS program, Finance needs to develop present value cost estimates.

Periodic evaluation studies need to be done to determine whether the program is meeting its objectives and to assess its impacts and effects.

Exhibit 33.5

Examples of Indicators for Monitoring Performance of Tax Assistance for Retirement Savings

Indicator	Actual and Potential Data Source
Performance and Achievement	
A. Currently Available	
1. Number of contributors by age group, sex and income range to	Revenue Canada Statistics Canada
– RPPs	
– RRSPs	
– RPPs and/or RRSPs	
2. Proportion of RPP members to labour force and of RRSP contributors to total eligible tax filers by age group and sex.	Statistics Canada
3. Proportion of workers (% of total C/QPP contributors) who are RPP members or RRSP contributors, by age group and sex.	Statistics Canada
4. Number and proportion of RPP members by type and size of plans.	Statistics Canada
5. Total and average amounts contributed to RPPs by employers, and by employees by income range, sex and age group.	Revenue Canada Statistics Canada
6. RRSP contribution room by income range, sex and age group.	Statistics Canada
7. Amount of RRSP withdrawals by beneficiaries below and over age 65.	Statistics Canada
8. Amount of assets in plans	Statistics Canada
– private sector	
– public sector	
9. Federal tax expenditures on TARS.	Finance, Revenue Canada and Statistics Canada
10. Government administration cost of TARS.	Revenue Canada
B. Obtainable Periodically with Some Difficulty in Near Future	
11. Investment of RPP assets	Revenue Canada Statistics Canada
– foreign	
– domestic (government, private)	
12. Compliance costs to plan sponsors	Pension Industry
– by size of employer	
– public vs private	
C. Difficult to Obtain	
13. Earnings replacement rates of pension income earners by income range, age, sex, and sources of replacement income:	Statistics Canada Revenue Canada and Finance
– C/QPP	Human Resources Development
– OAS, GIS	
– private and public pension plans	
– retirement savings plans	
– other income	
14. Savings induced by TARS	Revenue Canada and Finance
– private	
– public	
15. Other induced effects	Statistics Canada
– investment in real capital formation	

continued relevance and suggest alternatives.

Evaluation studies do not address key results and other issues of major concern

33.41 Finance did an evaluation study in 1989 (revised in 1990 and 1991) on the incidence of pension plans and public assistance to the elderly. Our Office reviewed the evaluation and noted that the Department had failed to examine the relevance or cost–effectiveness of the tax measures. Also, the study did not assess the possible effects of the tax measures on reducing financial pressure on public pension and social security programs, increasing personal savings, and other related effects.

33.42 The Department has done no additional formal evaluation studies of tax assistance for retirement savings. However, it has done other studies, such as a 1979 task force report, *The Retirement Income System in Canada: Problems and Alternative Policies for Reform* (the Lazar Report); the 1982 Green Paper, *Better Pensions for Canadians*; and, in 1984, *Building Better Pensions for Canadians: Improved TARS*. Other federal studies include the 1966 *Royal Commission on Taxation*, the 1979 *Report of the Special Senate Committee*

Exhibit 33.6

Questions to Help Develop Indicators for Evaluating Results of TARS

1. What is the target population of the program, e.g., by age and income/earnings range?
2. What is the extent of use by the target population, e.g., take–up rates and participation in pension plans?
3. How does this extent of use compare historically with past use?
4. What are the socio–economic and demographic characteristics of users and non–users of the program?
5. How many users of the program concurrently receive both RRSP and RPP benefits?
6. What characteristics of the program affect its use by particular groups – age, sex, income – and how is the use affected?
7. How does the program affect the behaviour of individuals and employers as reflected in workplace mobility and in the incidence and features of collective agreements?
8. Is savings behaviour modified significantly by the availability of other programs, e.g., CPP, OAS/GIS, the lifetime capital gains exemptions, preferential tax treatment of principal residences, lack of inflation indexing of investment income, taxation of bequests, and availability of universal health care?
9. When and how does the program provide a savings incentive?
10. To what extent is the program being used to achieve continuity of consumption in retirement, both before and after age 65?
11. To what extent would continuity of consumption suffer in the absence of the program?
12. Is the program being used to build larger estates? If yes, to what extent?
13. What are the characteristics of retirees with and without income continuity?
14. What proportions of their income are derived from public and private sources?
15. What is the income distribution pattern of retirees?
16. What is the trend in pre–retirement withdrawals?

on Retirement Age Policies and the 1983 *Parliamentary Task Force on Pension Reform.* The studies made several recommendations that helped to shape the present system of tax assistance for retirement savings.

33.43 In response to a request by the Public Accounts Committee, Finance prepared, in October 1992, an evaluation assessment of the reform of tax assistance for retirement savings. The evaluation assessment report included a framework for evaluating the reform of the limits on tax assistance for retirement savings, and identified nine issues for further study.

Evaluation studies planned by Finance leave many fundamental concerns unaddressed.

33.44 We found that progress in conducting the evaluations has been very slow. The summary plan prepared in 1992 scheduled four studies for completion in 1993 and the remaining five in 1993-1994. At the time of our audit, Finance officials informed us that work had started on three of the studies and that at least two should be completed by the end of 1994. They expect all of the nine studies to be completed by late 1996. A revised plan for the studies was to be reviewed and approved by the Department's Tax Evaluation Advisory Committee by the fall of 1994.

33.45 Our review of the plan shows that, although the evaluation studies are directed at evaluating the reform — as requested by the Public Accounts Committee — they will not address several key effects of the system. For example, the program's impact on pension income will not be examined, because it will take some time before changes in levels of pension income become apparent. While it is true that the impacts of reform will take some time to be manifest, this should not be an excuse for not evaluating the program's past performance.

33.46 Both the 1989 evaluation of the incidence of pension plans and public assistance to the elderly and the evaluation studies planned by Finance leave many fundamental concerns unaddressed. We noted that the aim of one of the studies planned by Finance is to identify areas of concern among employer and employee groups and, at a later stage, to provide more systematic analysis of those areas.

33.47 Exhibit 33.7 presents examples of issues of concern and related questions that we believe need to be addressed in future evaluation studies. Two of those issues, affordability and the burden of compliance cost, are discussed below.

33.48 Burden of compliance cost on plan sponsors and administrators needs to be assessed. A common concern among many plan sponsors is the cost to them of compliance. Finance has not assessed this cost burden since the 1990 reform. Plan sponsors continue to express concern about rising costs imposed on them, not only by the *Income Tax Act* and Regulations but also by the provincial *Pension Benefit Standards Acts*. This escalating compliance cost is cited as a major reason for some plan sponsors shifting from defined benefit plans to defined contribution plans, and to group RRSPs as an alternative to traditional RPPs.

33.49 An objective identified in Finance's 1992 evaluation assessment was to examine compliance costs to employers. The Department intends to cover the compliance cost issue in one of its planned nine evaluation studies, through consultations with employer and employee groups.

33.50 Affordability and fiscal implications need to be examined. We would expect Finance to assess the costs of the existing system as well as the

potential costs of alternative systems of tax assistance for retirement savings, and their implications for the deficit and the public debt in the context of the government's overall fiscal objectives.

We saw no evidence to suggest that this has been done or is planned.

33.51 To date, Finance has not undertaken estimates of the long–term tax

Exhibit 33.7

Issues of Concern and Related Evaluation Questions

Impacts

Income replacement: To what extent has the retirement income system improved retirement income levels and standard of living for senior Canadians? Are fears of a 21st Century generation of impoverished seniors well founded?
Dependency on public pension programs: To what extent is TARS reducing the pressure on public pensions? Are Canadians becoming less dependent on public pensions and other publicly funded retirement income programs due to TARS?
Coverage: What is the trend in the number and proportion of employees under employer pension plans? Are there significant numbers of employed people not adequately covered by pension plans or not contributing to RRSPs?
Impact on budgetary deficit: What is the revenue impact of TARS in the short and long terms?
Side effects: What are the secondary effects of TARS, e.g., on private savings and investment, and public "dis–savings"?
Risk to beneficiaries: What is the level of risk associated with allowable investments? Is this level appropriate? What are the extent and impact of underfunding of defined benefit plans?

Equity

Beneficiaries/users: Are concerns well founded that higher–income individuals derive substantially greater benefits from tax assistance for retirement savings than people with lower incomes? What is the appropriate level of income, relative to the average industrial wage, up to which tax assistance should be provided?
Factor of 9: Concerns remain and studies by actuarial firms indicate that most defined benefit plans do not meet the criteria (Factor of 9) used to calculate pension adjustment; thus the system may penalize members of plans that do not provide ancillary benefits as generous as those underlying the determination of the Factor. What are the alternatives for addressing the issue?
Elimination of pension adjustment reversal(PAR): Concern continues to be registered with Finance that the removal of PARs from the tax system erodes the equity and ability of taxpayers to save adequately for retirement. What are the options for resolving this issue?

Cost

Affordability: Are the implications of the current and projected costs of TARS assessed?
Burden of compliance cost: Are the concerns of plan sponsors and administrators that the system imposes undue cost burdens on them valid?

Alternatives

Costs and benefits: Have the costs and benefits of various tax treatment options for delivering incentives for retirement savings been adequately examined?
Tax deductions vs. credits: Which is more cost–effective and equitable — tax deductions or credits?
Restrictions on RRSPs similar to those on RPPs: Should penalties for early withdrawals from RRSPs be imposed to encourage greater availability of funds upon retirement?

expenditure cost of the TARS program that take into account the fact that tax deferrals ultimately will be recoverable, at least in part, when funds are withdrawn from RPPs and RRSPs. Once the plans have reached the stage of maturity when contributions equal withdrawals, the ongoing tax expenditure will arise largely from deferral of tax on interest earned by the assets of the plans. As a result, long–term cost estimates may be significantly different from the costs implied by the short–term estimating techniques used by Finance. Officials of that Department informed us that they are examining the feasibility of developing a long–term model to capture the deferral aspects of the program, as part of the policy review promised in the February 1994 Budget, *Preparing For An Aging Population.*

Information to Parliament Needs to Be Improved

33.52 We would expect the Department of Finance to keep Parliament adequately informed on the operation of such a significant program as TARS. This means reporting in its Part III of the Estimates, or in any other regularly published accountability document, the following:

- its own responsibilities regarding TARS and the program's effectiveness;
- consolidated summary–level information on the cost and operation of the complete TARS program including that part carried out by Revenue Canada; and
- estimates for past years and projections for future years for TARS.

33.53 Finance's Part III for 1994–95 is silent on its own responsibilities for the operational, financial and results aspects of the TARS program. It also contains no information on the roles and responsibilities of other departments involved in the program. Furthermore, there is no reference to where such information can be found.

33.54 In our 1992 chapter on departmental reporting, we noted that there was little information in Finance's Part III on its stewardship responsibilities for major areas such as tax expenditures, or references to where it can be found. In its 1994 Part III, Finance included a reference to *Personal and Corporate Income Tax Expenditures* and listed other studies and analyses of existing tax measures undertaken over the previous year, but did not provide brief summaries of the findings.

33.55 We believe that Finance needs to include in its Part III, or in any other regularly published accountability document, an overview of TARS and other significant tax expenditures. This entails notifying Parliament when evaluations of specific tax expenditures are completed, providing a brief summary of the evaluation findings and disclosing where the detailed report can be obtained.

33.56 For example, in 1989 Finance did an evaluation on the incidence of pension plans and public assistance to the elderly. However, the report was not referred to in Finance's Part III or made available to Parliament and the public during the debate on the legislation for pension reform. Yet that report declares that it was intended to stimulate public and parliamentary discussion.

33.57 Finance officials have informed us that the Department has now established a standard procedure for disseminating information on evaluation studies it completes. These procedures include issuing a press release on the study and sending copies to the Standing

Committee on Public Accounts and to each member of Parliament.

33.58 In 1990 the Standing Committee on Finance asked the Department of Finance to study the following issues and report back before the end of that year:

- the availability of alternative forms of retirement income;
- the possibility of changing tax deductions for retirement savings into tax credits; and
- the desirability of measures that would narrow the differences between registered pension plans and registered retirement savings plans (for example, RRSPs are not subject to many of the restrictions imposed on RPPs, such as locking in and survivor benefits).

33.59 Finance officials completed two of the studies requested by the Committee: one on the implications of replacing deductions for pension and RRSP contributions by tax credits, and the other on restrictions on RRSPs. They indicated that the third study was made redundant by the extension of the payout period for RRIFs in the 1992 Budget. Yet the Department never released the two completed studies directly to the Committee or informed it through the Part III that the reports of the studies were available.

Documentation was inadequate for a cost estimate provided to Parliament

33.60 We would expect cost estimates provided to Parliament to be adequately supported and documented.

33.61 In a 1990 presentation to the House of Commons Finance Committee, the Department of Finance said that the tax revenue it would not collect in 1989–90 because of the TARS program was $5.5 billion. Three years later, in December 1993, the Department published a significantly different estimate of $12.5 billion in the *Government of Canada Personal Income Tax Expenditures*. Finance officials have advised us that the difference between the two estimates was due to a change in methodology. However, the Department was unable to provide us with adequate documentation to support the earlier estimate. Consequently, we are unable to provide any assurance to Parliament on the validity of the cost estimate of $5.5 billion presented to the Committee.

33.62 Finance also presented to the Finance Committee the projected cost of the 1990 reform of the TARS program. The Department concluded that the reform's net impact on revenue would be neutral. It estimated that, for fiscal 1991–92, there would be additional foregone revenue of $300 million to $350 million. At the same time, it estimated that this cost would be offset by revenue savings resulting from measures that included stopping unlimited salary deferrals in employee benefit plans, removing the deductibility of past service additional voluntary contributions, restricting transfers between plans and the rollover of pension payments into RRSPs, and preventing a major increase in RRSP limits through a continuing shift to non–contributory plans.

33.63 Current estimates of tax expenditures suggest that net cost to revenue increased by nearly $1 billion in 1991. However, Finance has no information on the portion of that increase that is attributable to the reform, or on some variables, such as direct transfers between plans, that will be necessary to verify the offsets. The Department plans to evaluate its estimate that the net impact of reform on revenue would be neutral in one of the evaluation studies it is undertaking for completion in 1996. The

objective of the study will be to obtain improved estimates of the impact of reform on tax revenues.

Differences with Provincial Pension Legislation Are Being Resolved

33.64 We observed that there is reasonable co-ordination and co-operation among Finance, Revenue Canada, the Office of the Superintendent of Financial Institutions (OSFI) and provincial pension bodies. The Canadian Association of Pension Supervisory Authorities (CAPSA) provides a forum for pension supervisors to resolve conflicts and inconsistencies. All provincial pension regulators and OSFI (which regulates pension plans of federally incorporated businesses) are members of CAPSA. Finance and Revenue Canada attend CAPSA meetings as observers twice a year. Issues of particular concern to CAPSA are differences in pension legislation among provinces and between provinces and the federal government.

33.65 In the course of our audit, pension experts brought to our attention certain areas of difference between the federal legislation and provincial legislation. Under the auspices of CAPSA, some of the differences — for example, reductions in benefits and refund of contributions — have been resolved, and amendments made to the *Income Tax Act*. Other issues, such as the equal periodic payments of pension and the treatment of eligible contributions under money purchase plans, are being addressed respectively through amendments to the legislation being drafted by Finance and discussions at CAPSA meetings.

33.66 Finance officials advised us that the Department has been working with Revenue Canada and CAPSA members to identify, assess and resolve potential areas of conflict. We encourage both Finance and Revenue Canada to continue to find ways to resolve those and any other differences.

Conclusion

Accountability to Parliament for TARS is inadequate

33.67 In our 1986 chapter on tax expenditures, we concluded that the Department of Finance was not adequately managing tax–delivered programs. We called for improved monitoring, evaluation and reporting of tax expenditures. Our conclusion from this audit is similar.

33.68 We have concluded that the accountability for the costs and results of the substantial tax assistance for retirement savings program needs to be improved. The objectives of the TARS program need to be clearly specified. Consolidated information on the cost, workings and results of the program, and on the roles and responsibilities of departments involved, is not regularly provided to Parliament. Evaluation studies of TARS by Finance need to address key results and other issues of major concern.

33.69 As the Department responsible for the policy and program design and the management of the TARS program, the Department of Finance should:

a) clearly state the objectives of the TARS program and clarify its role relative to other retirement income programs;

b) monitor and regularly account for the program by providing consolidated information on the estimated costs, results and workings in Part III of the

Estimates or in any other regularly published accountability document;

c) develop, in addition to estimates of tax expenditures for retirement savings made on a cash flow basis, alternative cost estimates using a present value method and other approaches to assist policy makers in assessing the longer–term fiscal implications of the TARS program;

d) complete the nine evaluation studies planned, and carry out further studies to address other key effects and major concerns;

e) establish an interdepartmental evaluation framework to ensure that TARS is evaluated in conjunction with other related public pension and retirement income security programs;

f) estimate and assess, in its further evaluation studies, the long–term costs and related fiscal implications of alternative systems of TARS; and

g) make reports on its evaluation studies available to Parliament to contribute to informed discussion, scrutiny and decisions about the TARS program.

Department's response:

a) *The Department of Finance believes that the objectives of tax assistance for retirement savings, and its role relative to other retirement income programs, have been clearly outlined in public documents. A recent example is the booklet "Pension Reform: Improvements in Tax Assistance for Retirement Saving", which was tabled in Parliament by the Minister of Finance on December 11, 1989. The objectives and role of tax assistance for retirement savings are described on pages 5 and 6 of that booklet.*

b) *The Department will consider expanding the scope of its "Personal and Corporate Income Tax Expenditures" document to meet this recommendation.*

c) *Cost estimates using the present value approach will be calculated and published in future editions of "Personal and Corporate Income Tax Expenditures".*

d) *Once the current evaluations of Tax Assistance for Retirement Savings are complete, consideration will be given to further evaluations such as those recommended by the Auditor General.*

e) *This approach will be examined in developing a possible evaluation framework for future evaluations of TARS.*

f) *This recommendation will be taken into account in developing any future evaluation framework for TARS.*

g) *For several years now, it has been the Department's policy that all tax evaluation studies are made public and, in particular, that they are provided to parliamentarians. This will continue to be the case.*

REVENUE CANADA

The Role of Revenue Canada in TARS

33.70 The Department is responsible for registering and monitoring plans to ensure compliance with the *Income Tax Act*.

33.71 **Registration of plans.** The registration of pension, retirement savings and deferred profit sharing plans is a prerequisite for claiming tax assistance for retirement savings. The registration process entails a front–end review of applications for plan registration and for amendments, to ensure that the plan texts comply with prescribed conditions and requirements. After an initial review of an application for registration, a plan is "deemed registered" if the application complies with the "prescribed manner" specified in the *Income Tax Act*. This proviso is intended to avoid holding up the operation of plans while they await full compliance review for final registration.

33.72 Registration of retirement savings plans is controlled by the Registered Plans Division of the Policy and Legislation Branch of Revenue Canada. The Division has a staff of about 115 persons. It provides a large number of publications and a national enquiries service to facilitate compliance by clients. It also approves eligible contributions to defined benefit pension plans, with assistance from the Office of the Superintendent of Financial Institutions.

33.73 About 75 of the Division's staff of 115, or 65 percent, are engaged in the front–end review work, the results of which are reported primarily in terms of submissions processed. The Division estimated that, as at 31 March 1994, a total of 33,143 plans were registered, broken down as shown in Exhibit 33.8.

33.74 The Division's records show that in 1993–94 it processed submissions for initial registration of 2,845 RPPs, approval of 19,918 RPP amendments, and approval of eligible contributions to 6,194 defined benefit RPPs. It processed submissions for approval, amendment or termination of 4,961 RRSPs, 1,571 DPSPs and 1,159 RRIFs, and answered 29,648 telephone enquiries and 3,874 written enquiries. The Division has taken initiatives to promote and facilitate compliance by publishing forms, guides, information circulars and newsletters. It also meets semi–annually with pension industry representatives to consult on their needs and opinions.

33.75 **Monitoring compliance.** The monitoring process comprises primarily audits: to verify that the plans continue to qualify for registration, to determine the validity of income tax deductions for contributions claimed by taxpayers, and to determine that withdrawals from, and

Exhibit 33.8

Number of Registered Plans at 31 March 1994

–	employer–sponsored registered pension plans (RPP)	22,536
–	registered retirement savings plans (RRSP)	3,460 *
–	deferred profit sharing plans (DPSP)	5,762
–	registered retirement income funds (RRIF)	581 *
–	registered investment funds	804

* These represent the number of specimen plans registered and not the number of individual contracts registered. The Division estimates that, to the end of 1992, it had registered over the years some 26.5 million RRSP contracts and 79,000 RRIF contracts.

transfers between, registered plans have been dealt with properly. The Registered Plans Division manages compliance programs designed to identify plans that do not comply with the terms of registration. Five of its staff of 115 provide functional direction for back–end compliance work. The Verification, Enforcement and Compliance Research Branch is responsible for auditing deductions claimed by taxpayers for contributions to and withdrawals from registered plans, and for auditing transfers between plans.

Audit Scope and Objectives

33.76 We examined how Revenue Canada administers the provisions of the *Income Tax Act* designed to provide tax assistance for retirement savings, with a view to:

- determining if the rules and procedures applied have been sufficient to assure an effective check on the right of registered plans to continue to qualify for registration; on the validity of the income tax deductions claimed by taxpayers; and on the proper tax treatment of withdrawals from, and transfers between, registered plans; and

- providing objective information to help Parliament scrutinize the administration of the program.

33.77 In the course of our audit, the matter of overlap between federal and provincial jurisdictions in areas of pension and retirement savings administration came to our attention and we explored opportunities to reduce it.

Observations and Recommendations

Need to Improve Monitoring of Compliance

Results of the front–end compliance review need to be summarized

33.78 We would expect the Registered Plans Division to maintain compliance profiles of pension plans for devising an appropriate compliance monitoring strategy.

33.79 Officials of the Division advised us that they discuss non–compliance at their management meetings. However, a review of the Division's quarterly and annual reports for 1993 and 1994 showed that it does not systematically maintain, analyze and report summary information on the results of its front–end compliance review, in terms of the nature, frequency and implications of non–compliance identified and forestalled. Such summary information would be useful for developing compliance profiles and appropriate compliance monitoring strategy.

There are delays and backlogs in registering plans and approving amendments

33.80 **Workload is increasing.** The 1990 reform of the legislation triggered amendments to many existing plans to conform with the revised legislation and regulations. As would be expected, the workload of the Registered Plans Division has increased. The complexity of the legislation also contributed to a significant increase in requests from plan sponsors, administrators and pension consultants for more information and explanations. The opening inventory of case files more than doubled in three years, from 8,363 in 1991–92 to 20,105 in

1994–95, notwithstanding a production increase of 12 percent over that three–year period.

33.81 Delays and backlogs are increasing. As at 31 December 1993, 36 percent of the case files were more than six months old, and at 31 March 1994, 40 percent were more than six months old. Some 390 files received between 1986 and 1991 still had not been completed at 31 December 1993. The backlog of plans awaiting approval for registration or amendment increased by 48 percent from 1991–92 to 1992–93 and by 41 percent from 1992–93 to 1993–94.

33.82 The delays have frustrated plan sponsors and administrators. As well, the delays have increased the risk that plans not registered and those not yet amended might be operating while not in full compliance. At the time of our audit, there was no information on the age of some 1,500 plans deemed registered, although some plans have been operating under "deemed registered" status for two years or longer. Delays of two years in registering and amending plans cause difficulties and expense to employers and plan sponsors, and they create business risks for pension plan developers.

33.83 Factors contributing to the delays and backlog include the increases in workload and the complexity of the legislation that have led to a significant increase in requests for more information and explanations. Departmental officials advised us that delays are sometimes caused by clients themselves, who may take nine to 12 months to reply to initial letters of request for further information. The causes of delays also include a lack of adequate and timely information for clients to facilitate their compliance. As well, the Department lacks formal standards for assessing its service performance. The Department recognizes these problems and has initiated steps to address them. For example, it has adopted a modified review process and is working on the development of service standards.

33.84 Service standards. The Registered Plans Division proposed standards for processing applications, responding to enquiries, and providing other services to clients. It conducted a survey of clients, and consulted managers to obtain their views and suggestions on standards.

33.85 There was a big gap between client expectations and the proposed standards of service. For example, while the Division's proposed service standards are four to six months for registration of new plans, and six to nine months for amendments and for terminations, the majority of clients surveyed expect these transactions to be completed within one month — an expectation the Department considers unrealistic. In its continuing effort to improve services, the Division subsequently proposed goals for quicker service to narrow that gap. However, the standards have not yet been published. The Department has stated that it will publish the standards in February 1995. The establishment and publication of service standards, and the monitoring and reporting of service performance against published standards, would provide an important basis for planning and managing reduction in delays and backlog.

Post–registration audit of plans and verification of transactions need to be improved

33.86 Registration of plans is not a sufficient proof of compliance with the legislation. Therefore, we would expect Revenue Canada to have systematic mechanisms, such as audits and maintenance of relevant information, to ensure that registered plans continue to

qualify for registration, to verify deductions claimed by taxpayers for contributions to pension and retirement savings plans and to verify the validity of withdrawals from registered plans and transfers between them.

33.87 Client compliance profiles are not formally maintained to target plans for audit. Revenue Canada does not maintain compliance profiles of registered plans to help it assess the risk of non–compliance and to target plans for audit. Officials of the Department informed us that they have personal knowledge of compliance profiles of registered plans and areas of risk. However, their knowledge is not systematically documented, maintained and summarized to help select plans for audit, to provide continuity in the Department's corporate memory, and to capture changes in risk profiles.

33.88 In addition, we note that annual information returns and tax forms do not provide sufficient information to select plans for audit. Officials advised us that they plan to redesign annual information returns to address the problem.

33.89 Summary information on the nature, frequency and revenue implications of non–compliance identified through front–end compliance review, as well as through post–registration regular audits, is not maintained to help develop compliance profiles.

33.90 Without compliance profiles and sufficient information on annual information returns and tax forms, the Department's ability to identify and audit cases of potentially significant non–compliance is hindered.

33.91 Audit coverage is inadequate to monitor pressure points in the system. We identified areas where significant non–compliance could occur (referred to as "pressure points") and reviewed Revenue Canada's audit program and other procedures to ascertain whether they include the necessary steps to assure compliance in those areas. Some of the pressure points are shown in Exhibit 33.9.

33.92 Revenue Canada's audit programs have steps to monitor these pressure points and to monitor contributions to, and investments of, pension plans to ensure that they conform with the requirements of the legislation. However, the low level of audit coverage inhibits any effective and in–depth review of those areas (see paragraphs 33.93 to 33.97). In the circumstances, regular audits need to be supplemented with special projects to determine the nature and magnitude of non–compliance in those areas. The Registered Plans Division has carried out such special projects to examine terminated pension plans for excess transfers; it also examined executive pension plans to determine if contributions were contravening an anti–avoidance rule.

The low level of audit coverage inhibits any effective and in–depth review of areas where significant non–compliance could occur.

33.93 The number and coverage of audits concluded in 1992–93 and 1993–94 are summarized in Exhibit 33.10.

33.94 Revenue Canada concluded 23 regular audits of registered pension plans in each of the years 1992–93 and 1993–94. On an annual basis, the regular audits represent about 0.1 percent of the 22,536 registered pension plans. In 1992–93, a total of 127 plans were audited, out of some 33,000 deferred income plans of all types. In 1993–94, a total of 82 regular audits were concluded plus 26 special project audits.

33.95 Of particular concern is the extremely low audit coverage of registered pension plans (RPPs). At 31 March 1994, these plans represented 68 percent of all plans registered with Revenue Canada. Yet the 23 regular

Exhibit 33.9

Examples of Areas of Potentially Significant Non–compliance

PRESSURE POINTS

RRSPs

Treatment of loans for RRSP contributions

- Interest on loans for purpose of making RRSP contributions is not deductible.

Unqualified investments: borrowing or use of funds by annuitant

- Individuals are not allowed to borrow funds from an RRSP in which they are an annuitant, nor can the RRSP lend funds to a related party or a business.

Other beneficial use of funds prior to withdrawal

- Plan members should not in other ways obtain beneficial use of funds prior to withdrawal, such as by use of assets as collateral for a loan.

Spousal plans: short–term withdrawals

- Where there are withdrawals from a spousal plan within three years of a contribution, the withdrawals are attributed back to the contributing spouse.

Post–death growth in plan values

- The growth in plan value between death and the distribution of assets requires determination of the tax treatment of these amounts.

Withholding tax on withdrawals

- Incorrect withholding tax could be applied on withdrawals by non–residents.

RPPs

Members of foreign pension plans

In general, for residents and expatriates who are members of foreign pension plans, there should be either tax on vested benefits as a retirement compensation arrangement or a pension adjustment calculated. Special rules apply for expatriates for the first five years.

Eligible service

Pension benefits are determined according to eligible service, which must meet the requirements of the Act.

Eligible foreign service

- Eligible service from periods of employment outside Canada is limited to three years.

Post–retirement additions to service

- Eligible service relates only to a period in which a member is employed and receives remuneration; contributions to the plan cannot be continued after retirement.

Payment of administration costs by fund

Where administration costs are paid by the pension fund rather than the plan sponsor, the proper tax treatment of the payments is required.

DPSPs

Existence of employee contributions or ineligible members

Rules relating to the property of the trust, such as non–qualified investments, use as collateral for a loan, loans to employees, and transfers at other than fair market value

Failure to make timely payments to beneficiaries

Failure to meet reporting requirements

RRIFs

Failure to withdraw funds from plans as required

Treatment of funds when beneficiaries not located

Note: These pressure points indicate the general nature of the compliance issue. For detailed information, reference to the relevant provisions of the Income Tax Act *and the Regulations is necessary.*

audits of registered pension plans represented only about 18 percent of all regular audits of plans in 1992–93, and 28 percent in 1993–94.

33.96 Moreover, although public sector plans accounted for 48 percent of pension plan membership at 1 January 1992, no audits of public sector plans have been undertaken to date.

33.97 In our opinion, audit coverage is not sufficient to detect and deter non–compliance. In our 1990 audit of Revenue Canada's enforcement of the *Income Tax Act*, we also expressed concern about the low level of audit coverage for various activities.

33.98 The review and approval of contributions to defined benefit plans is reasonable. For an employer's contribution to a defined benefit plan to be deductible from income, it must be ruled an eligible contribution or must be made on the recommendation of an actuary. The contribution must be approved by the Minister of National Revenue, in writing, on the advice of the Office of the Superintendent of Financial Institutions.

33.99 With the assistance of actuarial experts, we reviewed the procedures for assessing the eligibility of contributions to defined benefit plans. We found them to be reasonable. As no actuarial calculations are required for defined contribution plans, these plans are not subject to the same sort of review as defined benefit plans.

33.100 Verification of pension adjustment is adequate. Each deferred profit sharing plan and each registered pension plan produces a pension credit for the member. The pension credit is a measure of the value of the benefit earned or accrued during the calendar year. A member's pension adjustment (PA) is the total of that member's pension credits from all plans in which the member's employer participates in the year, excluding registered retirement savings plans.

Exhibit 33.10

Registered Plan Audits Concluded, by Type of Plan, 1992–93 and 1993–94

Type of Plan	Number of Plans*	1992–93 Number of Audits	1992–93 % Coverage	1993–94 Number of Audits	1993–94 % Coverage
RPPs	22,536	23	0.1	23**	0.1
DPSPs	5,762	27	0.5	9	0.2
Specimen RRSPs	3,460	26***	0.8	19	0.5
Registered Investments Funds	804	37	4.6	23	2.9
Specimen RRIFs	581	14	2.4	8	1.4
TOTAL	**33,143**	**127**		**82****	

* Estimates by Revenue Canada of number of plans at 31 March 1994. These estimates have not changed significantly in the past 2 years.

** In addition, 26 audits for a special project were done on Executive Pension Plans. The project started in 1992 and was completed in 1993. The project was undertaken because Revenue Canada was concerned about contributions made to a pension plan in certain circumstances were contravening a specific anti–avoidance rule in the Income Tax Regulations.

*** In addition, 206 RRSP audits of individuals were undertaken in 1991–92 and 1992–93.

33.101 It is the responsibility of the employer to calculate a pension adjustment for each plan member. The employer must report the pension adjustment for each employee to Revenue Canada on the T4 or T4A information slip by the last day of February each year.

33.102 We examined Revenue Canada's procedures for verifying employers' calculations of pension adjustments and found them to be reasonable.

33.103 Past service pension adjustments (PSPA) are not systematically verified. In addition to the benefit earned by a member for a current year (reflected in the member's pension adjustment), pension benefits may improve as a result of events related to past service. These "past service events" occur for periods of past service after 1989 where benefits are increased retroactively, where an additional period of past service is credited to the member, or where there is a retroactive change in the way the member's benefits are determined.

33.104 Administrators of defined benefit plans are responsible for calculating and reporting PSPAs when necessary. Reporting of PSPAs did not start until 1992 because of delays in promulgating the Income Tax Regulations. To June 1994, Revenue Canada had processed $187 million in PSPAs.

33.105 Officials informed us that the Department does not verify plan administrators' calculations of PSPAs systematically.

33.106 Because the calculation of PSPAs is not verified, it is not known if they are being calculated and reported in accordance with the Income Tax Regulations. Any understatement of PSPAs could result in contributions to RRSPs that exceed the limit, since PSPAs reduce the amount that taxpayers can deduct for contributions to an RRSP.

33.107 Lack of information to verify RRSP contributions. In 1992, $16 billion was contributed to RRSPs. However, there is no requirement for issuers of RRSPs, mainly financial institutions, to submit information to Revenue Canada showing contributions made to RRSPs by purchasers. Thus, no matching is possible as is done for pension plan payments and registered plan withdrawals, which require that information slips be submitted. Consequently, the Department has virtually no information from an independent source to determine the validity of deductions claimed by taxpayers, or to determine if there are significant contributions over the permissible cumulative limit of $8,000 on "over–contribution". In effect, the Department has limited means in place to ensure compliance with *Income Tax Act* rules for contributions to registered retirement savings plans.

33.108 The problem of lack of information for verifying RRSP contributions has been further affected by the introduction of electronic filing (EFILE). Taxpayers using EFILE are not required initially to submit any supporting documentation. In our 1993 audit of Revenue Canada's electronic filing of individual income tax returns, we observed that there could be significant potential for revenue loss if taxpayers' voluntary compliance deteriorates.

33.109 Deferred profit sharing plan contributions and withdrawals are not known. Revenue Canada does not have the information on the amounts of contributions to and withdrawals from DPSPs needed to effectively plan the audit of those transactions.

33.110 Validation of withdrawals is inadequate. In 1992, withdrawals in the form of periodic payments and transfers amounted to $19 billion from RPPs, $4.7 billion from RRSPs and $1.8 billion from registered retirement income funds.

33.111 The Verification, Enforcement and Compliance Research Branch audits withdrawals from registered plans. Information on tax slips (T4A, T4RSP, T4RIF) showing withdrawals from registered plans is taken as accurate in the initial assessment of returns. When doing its matching programs or verifying supporting information on tax returns, the Department does not question the amounts on those slips. Responsibility for reviewing their accuracy rests with the Registered Plans Division. The Division verifies validity as part of its audit of registered plans. However, as we have noted, audit coverage is extremely low.

33.112 Legislation no longer requires reporting of information on direct transfers between plans. Many annual direct transfers between plans are not reported to Revenue Canada because, under the new legislation, there is no longer a requirement to do so. The *Income Tax Act* sets limits on transfers from RPPs to other vehicles. Without a requirement to provide information on the amounts transferred, the Department has no information to verify if the limits on direct transfers have been exceeded and excess amounts transferred without being taxed. The Department did identify excess contributions in a review of terminated pension plans for direct transfers from RPPs to RRSPs.

33.113 Revocation needs to be supplemented with other sanctions for non–compliance. Sanctions and penalties for non–compliance by plans are stipulated in the *Income Tax Act*. They include monetary penalties, revocation of registration, summary conviction and fines. For example, the legislation imposes monetary penalties for failure to meet statutory deadlines, while revocation applies to registered plans that do not comply with the prescribed conditions for registration or that are not administered in accordance with their terms as registered, or for other violations set out in ss. 147.1 (11) of the Act.

33.114 Revocation is used, usually in rare cases that involve flagrant non–compliance and where revocation does not prejudice employee beneficiaries. Revenue Canada asked Finance in 1993 to develop alternative sanctions, primarily monetary penalties, against employers and plan administrators who fail to bring a plan into compliance with the conditions of registration for cases where revocation is considered inappropriate. Finance is still considering that request.

33.115 Compliance monitoring strategy has not been reviewed. Since the 1990 reform, the Registered Plans Division has not carried out a review of its approach to compliance monitoring. It has continued to apply its front–end compliance review strategy, with little emphasis either on back–end audits of registered plans or on determining the validity of transactions — contributions, withdrawals and transfers.

Since the 1990 reform, the Registered Plans Division has not carried out a review of its approach to compliance monitoring.

33.116 Officials of the Department informed us that, following the 1990 reform to the legislation, they made a conscious decision to continue using the same front–end compliance review strategy. They maintain that the legislation dictates the present approach. However, no study or review of that strategy has been carried out to compare it with alternative strategies or approaches for achieving the same results.

Information to Parliament Needs to Be Improved

33.117 Revenue Canada presents administrative data in its Part III of the Estimates, such as the numbers of registered pension plans, new plan registrations and amendments processed, telephone and written enquiries handled and guides issued.

33.118 However, it does not report the results of its compliance activities, such as the number of plans found to be non–compliant and the associated implications for revenue loss. Also, there are no cross–references to other departmental sources of information — for example, *Taxation Statistics*, which provides the number of contributors and the amount of contributions to pension and retirement savings plans.

Co-ordination with Provinces

33.119 We explored, with the assistance of pension experts, potential opportunities to reduce overlap of federal and provincial administrative procedures for registering and monitoring pension plans.

33.120 For example, the administrative actions of the Régie des rentes du Québec, the Pension Commission of Ontario and those of Revenue Canada are similar in such areas as the registration of pension plans, examination of plan documents and review of actuarial valuation reports. Departmental officials informed us that they initiated a joint project to study the feasibility of harmonizing the federal and provincial annual information returns, so that there would be one return required instead of two. The project is nearing completion. Ontario intends to adopt registration numbers for pension plans that are the same as those of Revenue Canada to facilitate communication between the two levels of government, and other provinces have expressed interest in following suit.

33.121 Other potential areas for co-ordination of administrative actions include compliance reviews, monitoring of pension plans and the maintenance of a central filing system containing all official pension plan documents.

33.122 As Revenue Canada and the provincial pension authorities examine essentially the same pension documents, they could co-ordinate their activities so that one jurisdiction could have the other carry out the examination on its behalf, thereby improving overall efficiency and achieving cost savings. We encourage the Department to continue to seek, through the Canadian Association of Pension Supervisory Authorities, ways of making the administrative actions of the various jurisdictions compatible, to reduce duplication and overlapping of operations.

Conclusion

The current compliance strategy needs to be improved

33.123 The observations noted earlier lead us to conclude that the rules and procedures applied by Revenue Canada need to be improved to assure an effective check on the right of registered plans to continue to qualify for registration, on the validity of the income tax deductions claimed by taxpayers, and on the proper tax treatment of withdrawals from, and transfers between, registered plans.

33.124 The Department intends to deal with most of the areas requiring improvement noted in this chapter through the initiatives listed in Exhibit 33.11. We would expect the Department to monitor and regularly report to senior management on their implementation. We will follow up and report on this in future audits.

33.125 In order to deal more fully with the required improvements, Revenue Canada should:

a) review its compliance strategy and explore ways to improve it. If the legislation precludes the Department from adopting a more effective compliance strategy, it should seek changes to the legislation;

b) implement a verification program for RRSP contributions and transfers between registered plans to ensure that those transactions are within the prescribed limits;

c) obtain information on the amounts of contributions to, and withdrawals from, deferred profit sharing plans, to enable it to effectively design and implement an audit program to verify the transactions;

d) continue to urge the Department of Finance, emphasizing the need, to formulate effective penalties for cases where revocation is considered inappropriate; and

e) provide to Parliament, in Part III of the Estimates, information on the results of its compliance activities with respect to TARS.

Department's response:

a) *The Department will develop and implement a system to maintain and report summary information on the results of front–end compliance review as well as audit results. This information will assist in the assessment of the effectiveness of its current compliance strategy with regard to Tax Assistance for Retirement Savings. If changes to legislation are required, they will be discussed with officials of the Department of Finance.*

b) *The Department does not agree. There is currently a verification program in place.*

Procedures are in place to verify RRSP deductions. While many RRSP claims are accepted on the initial assessment of the T1 return (both paper and EFILE returns), clients are required to substantiate their claims by sending in receipts upon request.

Exhibit 33.11

Tax Assistance for Retirement Savings – Revenue Canada's Initiatives

Initiative	Description	Target Date
Front–end compliance	Develop and implement a system to maintain and report summary information on results of front–end compliance review.	December 1994
Service standards	Publish client service standards for processing applications and responding to enquiries.	February 1995
Client compliance profiles	Document client compliance profiles to facilitate the assessment of the risk of non–compliance and to target plans for audit.	October 1995
Audit coverage	The 1994–95 audit program improves audit coverage significantly. The Audit program is made mandatory and increases the overall number of audits to be conducted.	Fiscal year 1994–95
Past service pension adjustments	A pilot program to verify past service pension adjustments will be initiated.	early 1995

The Department is aware of the importance of monitoring clients' voluntary compliance with the Income Tax Act. *The Department's upfront verification steps (error clues and confidence validities), as well as the post processing review program, provide the necessary safeguards to ensure that clients' RRSP claims are valid.*

The Department's audit program includes the verification of transfers between registered plans.

c) *The Department does not agree that by obtaining the cited information it could more effectively design and implement its audit program. The existing audit program for DPSPs addresses all of the pressure points listed in Exhibit 33.9.*

d) *The Department's objective is to ensure compliance with the requirements of the* Income Tax Act *and Regulations. We will continue to work with officials of the Department of Finance to secure penalties as appropriate.*

e) *The Department will provide information on its compliance activities with respect to TARS, provided that the information is significant and warrants inclusion in Part III of the Estimates.*

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Report of the Auditor General of Canada to the House of Commons

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Chapter 34



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1994

VOLUME 17

Chapter 34

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The audit work reported in this volume was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

Chapter 34

Public Works and Government Services Canada

Management and Operation of Crown–owned Office Buildings

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Assistant Auditor General: David Rattray
Responsible Auditor: Bernard Barry

Public Works and Government Services Canada

Management and Operation of Crown–owned Office Buildings

Main Points

34.1 Extensive internal and external changes are impacting on the Public Works component of Public Works and Government Services Canada. These include: an ageing inventory, a marked downturn in the real estate market, a restructuring of government departments, innovations in workplace design and modifications in the requirements for office space.

34.2 To meet these challenges, the Department needs to improve its strategic management of real property. It should ensure that accommodation planning is better linked to government program plans and is carried out in close collaboration with Treasury Board and other key players who share this responsibility. The Department's two recent policy initiatives, the National Investment Strategy and Shared Accommodation Leadership, should help foster a strategic approach.

34.3 In general, the 28 office buildings we examined — some old and deteriorating, others quite modern — were reasonably well operated and maintained, providing an adequate quantity and quality of space to federal departments.

34.4 More efficient management of Crown–owned office buildings and opportunities for savings are possible through developing and carrying out a renovation policy to optimize space usage and implementing energy and water savings initiatives.

34.5 The government faces two fundamental issues: Should departments pay rent for accommodation? Should departments have greater freedom in choosing their own office space? These issues need to be addressed as a matter of urgency.

34.6 Since space is provided free to most departments, there is little incentive for them to limit their use of it. In order to ensure proper management of office accommodation, the government should hold tenant departments accountable for the efficient use of their office space.

34.7 Public Works and Government Services Canada should provide office accommodation and service to departments with clear and consistent delineation of staff roles and responsibilities and project leadership.

34.8 While carrying out initiatives to simplify and reduce the costs of its services and administrative practices, the Department should improve its management information on asset condition, building maintenance and operating costs and performance, and departments' use of space.

Introduction

34.9 The Department of Public Works and Government Services (Public Works and Government Services Canada) was created by the amalgamation, in June 1993, of the departments of Public Works and Supply and Services, the Government Telecommunications Agency and the Translation Bureau.

34.10 The mandate of the Public Works component of the Department is to attend to the government's office requirements and other real property needs; to offer expert advice and services in the provision, management, operation and disposal of federal real property; and to help meet the nation's social and economic objectives.

Background

34.11 The federal government owns or leases approximately 25 million square metres of space in 59,000 buildings. The inventory includes a wide variety of structures, such as general office buildings, warehouses, museums, laboratories, and educational and conference facilities. The buildings also vary in size, age, physical condition, construction material and style.

34.12 Under Treasury Board policy, Public Works has responsibility for administering general purpose office and certain common–use facilities for the government. As shown in Exhibit 34.1, approximately 27 percent of the total inventory of federal space has been assigned to Public Works, with the remaining 73 percent assigned to other departments. Public Works is the mandatory provider or sole source of office space for departments and provides accommodation for approximately 165,000 full–time equivalent public servants. (In government terminology, a "full–time equivalent" is one person working full–time for one year.) The Department is also custodian of a number of other facilities, including the Parliament Buildings and certain bridges and highways.

34.13 Public Works' inventory amounts to 6.9 million square metres for both office space and other federal facilities

Extensive internal and external changes that have impacted on Public Works over the past several years include an ageing inventory; a marked downturn in the real estate market; government restructuring; and innovations in workplace design.

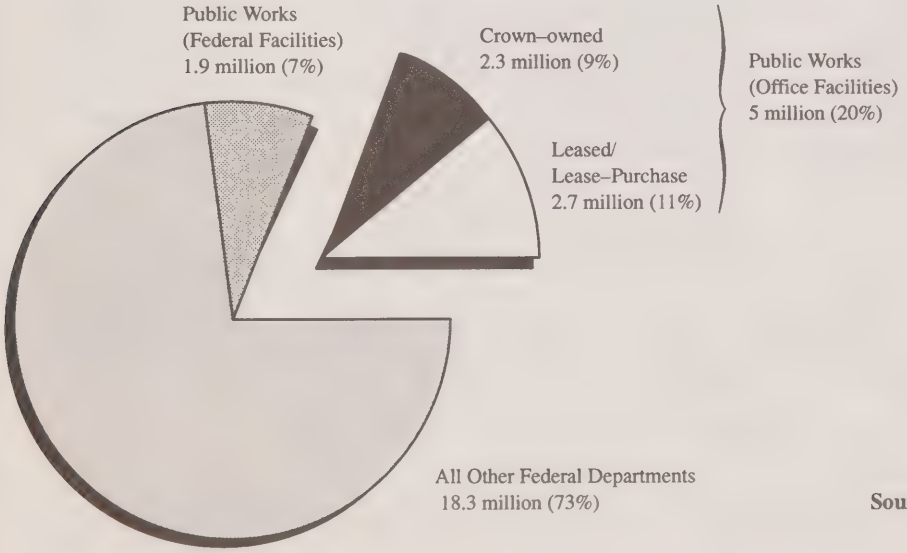


Exhibit 34.1

Federal Building Inventory, Owned and Leased
(square metres)

Source: Directory of Federal Real Property 1993; Treasury Board Secretariat

(see Exhibit 34.1). In 1992–93, Public Works provided about 5 million square metres (see Exhibit 34.2) of office space, of which 2.3 million square metres was in 367 Crown–owned buildings. The total cost of the Public Works Real Property Program in 1992–93 was $1.8 billion. Gross annual expenditures related to office facilities made up approximately $1,040 million of this amount, with about $700 million for leased office buildings and $340 million for Crown–owned office buildings. Gross expenditures for Crown–owned office buildings include operating and capital expenditures but exclude grants paid to municipalities in lieu of taxes.

34.14 In 1991, we examined the planning and acquisition of leased office space. Our current audit concentrated on the management and operation of Crown–owned office buildings.

Public Works Environment

34.15 Extensive internal and external changes over the past several years have impacted on Public Works. These changes include: an ageing inventory; a marked downturn in the real estate market; government restructuring, downsizing and streamlining initiatives; innovations in workplace design and modifications in the requirements for traditional office space to provide for the installation of new technology, communications and data processing equipment.

34.16 Another important issue for the Department is the Federal Government Program Review, announced in the 1994 Budget. This review is examining government programs to ensure that they provide services in the most efficient and cost–effective way possible.

34.17 Each of these changes has created a unique challenge for the Department in a period of marked budgetary constraints.

34.18 As well, because of its broad mandate as a "procurement" department, Public Works has historically been one of the government's vehicles for achieving social and economic objectives, such as increasing employment and stimulating regional development. A recent example of such development is the construction of the new Goods and Services Tax Centre in Summerside, Prince Edward Island.

Audit Objective and Scope

34.19 Our overall audit objective was to determine whether departmental practices for managing Crown–owned office buildings provide reasonable assurance that:

- building services to tenants are provided in a timely and responsive manner;

Exhibit 34.2

Public Works Office Accommodation, 31 March 1993

	Number	Thousands of Square Metres of Office Space	Percentage Share
Crown–owned buildings	367	2,321	47
Lease–purchase buildings	10	561	11
Leases	2,805	2,120	42
		5,002	100

Source: Public Works and Government Services Estimates: Part III; 1994–95

- the buildings are adequately preserved and protected;

- the buildings are operated and maintained in an economic and efficient manner consistent with occupants' operational requirements; and

- applicable government policies, laws and regulations are complied with (for example, health and safety).

34.20 Exhibit 34.3 shows the key organizations involved in the management of Crown–owned office facilities.

34.21 To examine the management, operations and maintenance of Crown–owned office buildings, we:

- visited 28 office buildings of various sizes and types and interviewed responsible staff at all levels in the five regions of the country;

- discussed office accommodation planning, management and accountability issues with senior Public Works officials at headquarters and in the regions;

- consulted with real estate professionals in the public and private sectors; and

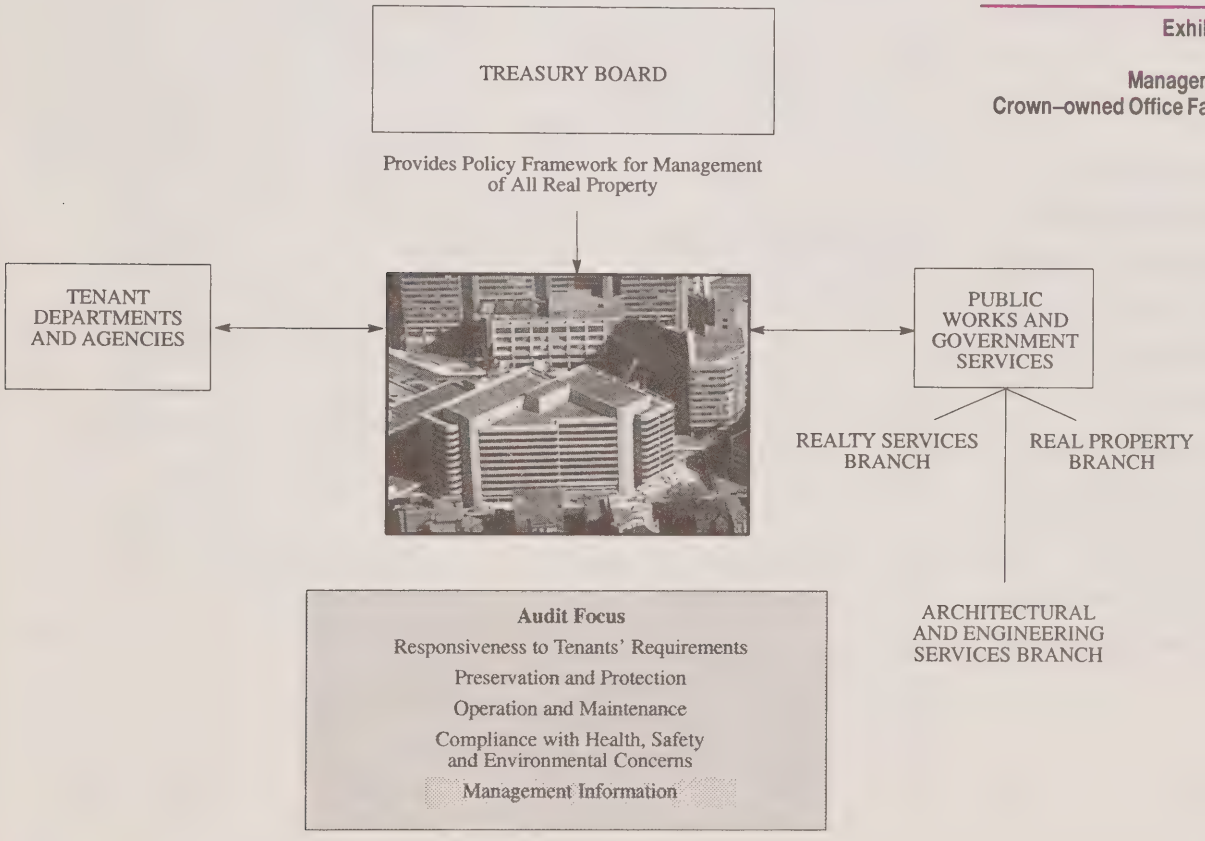
- reviewed information on accommodation management from other jurisdictions.

Lessons from Other Jurisdictions

34.22 In recent years, countries other than Canada have introduced significant reforms in their management of real property. The General Accounting Office in the United States recently issued a report on the reforms in Australia, Canada, the United Kingdom and Sweden.

Exhibit 34.3

Management of Crown–owned Office Facilities



In general, the 28 office buildings we examined were reasonably well operated and maintained; also, the quantity and quality of space provided to federal departments were adequate.

34.23 The September 1994 report, entitled *Real Property Management: Reforms in Four Countries Promote Competition*, noted that the real property organizations in all of the countries were facing similar problems: "poor business practices; inadequate strategies for managing real property assets; conflicting roles as both the building service provider and the oversight agency; customer dissatisfaction; and barriers to the timely acquisition, maintenance, and disposal of real property." The real property reforms in these countries were characterized by: "(1) introducing competition for real property services; (2) providing more strategic management of assets, that is, in a manner that recognizes the need to manage these assets as investments and to meet customers' mission needs; and (3) separating building services from asset management (except for Sweden) and policy oversight and development roles."

34.24 The reform experiences in other countries can help Public Works and Government Services improve the structure and management of real property in Canada.

Observations and Recommendations

34.25 In general, the 28 office buildings we examined were reasonably well operated and maintained; also, the quantity and quality of space provided to federal departments were adequate. While some buildings are obviously old and deteriorating, others are modern commercial office buildings.

Regardless of how well buildings are maintained on a daily basis, major systems replacements or overhauls are generally required about every 20 to 30 years to preserve their asset value and to keep them operational.

34.26 The costs of operating and maintaining Crown–owned office buildings are relatively fixed, at least in the short run. Consequently, there are no quick fixes to improve the management and operation of Crown–owned office buildings. The areas we have cited for improvement will require significant investment of resources, innovative planning and careful implementation on the part of Public Works and Government Services managers over the next decade.

34.27 Our audit observations and recommendations cover three main areas: strategic planning for accommodation, office building operations, and accountability and incentives in managing office buildings.

Strategic Planning for Accommodation

34.28 In our 1991 audit of leased office space, we noted that several long–standing accommodation issues remained unresolved despite years of discussion and study. One of those issues related to the inability of the Department to develop a long–term strategic approach to the provision of accommodation. The continuing need for such an approach is discussed in this section of our chapter. We also describe the critical elements in accommodation planning and outline the Department's National Investment Strategy. Exhibit 34.4 shows the current major components in planning government accommodation.

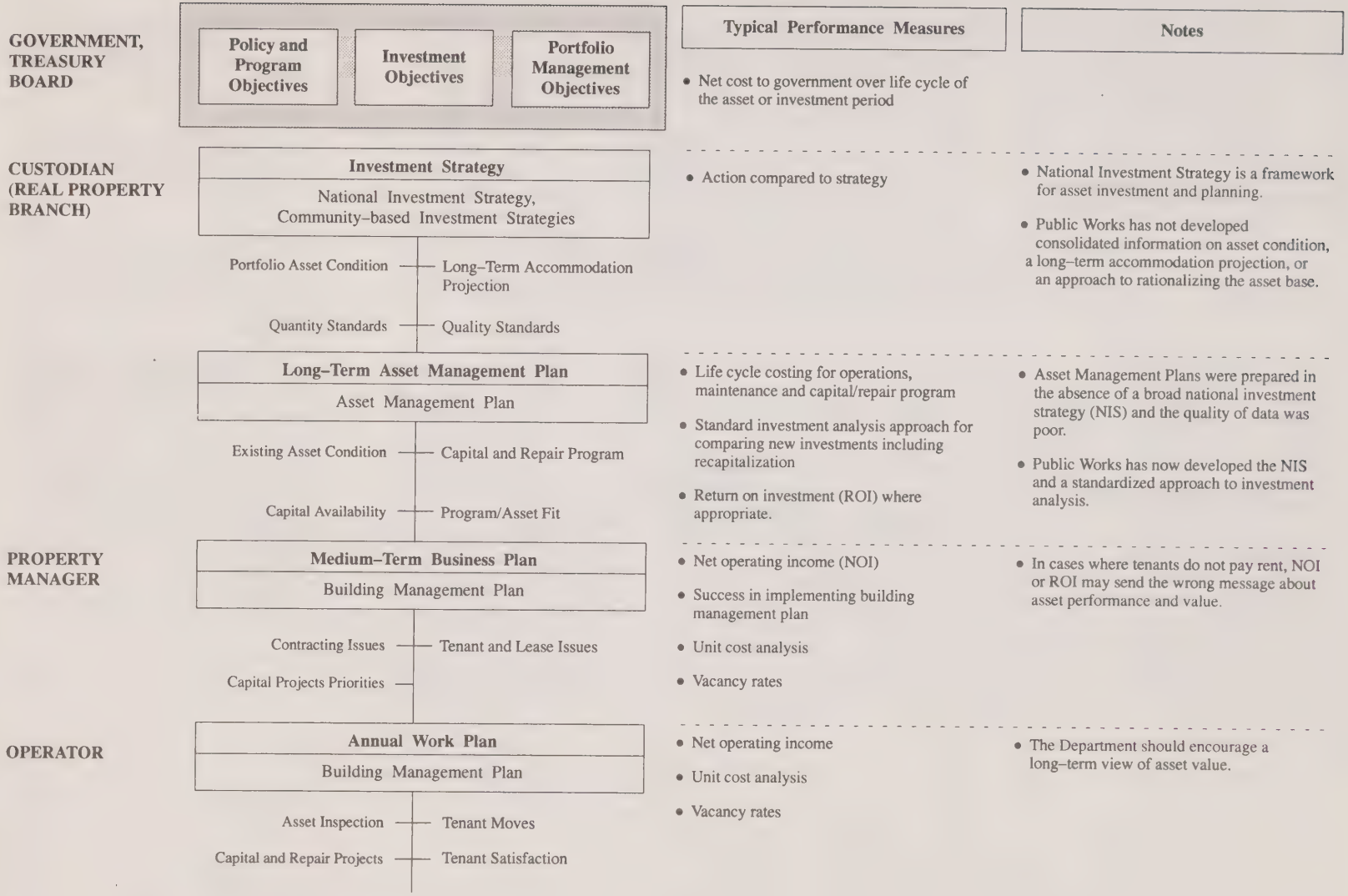
Ageing Crown–owned buildings

34.29 Regardless of how well buildings are maintained on a daily basis, major systems replacements or overhauls are generally required about every 20 to 30 years to preserve their asset value and to keep them operational. Without major reinvestment to modernize them, buildings gradually become obsolete and no longer provide productive working space for the occupants.

34.30 The average age of the Crown–owned office buildings in the Public Works portfolio is over 40 years.

Exhibit 34.4

Planning Government Accommodation



However, a significant portion, approximately one third, of the office space is in buildings that are less than 20 years old (see Exhibit 34.5). According to departmental officials, about 80 of the 367 buildings require upgrading of their structures and their lighting, mechanical, electrical and safety systems.

34.31 In 1986, the Treasury Board approved a management policy and framework for heritage buildings to be administered by the Federal Heritage Building Review Office under the Canadian Parks Service of the Department of Canadian Heritage. According to that policy, all government buildings over 40 years old require a heritage review prior to significant action. Since many of the buildings in Public Works' Crown–owned inventory fall into this category, the Department needs to consider the impact of the heritage policy in developing its long–term plans for facilities.

Funding requirements

34.32 The consequences of not carrying out adequate building maintenance and repairs are loss of asset value, poor quality of working space, potential health and safety problems, the probability of higher repair costs in the future, and increasing reliance on more costly leased accommodation.

34.33 During the past ten years, funding limitations have prevented the Department from undertaking the major renovations required to keep its asset base current. Based on industry averages, departmental officials currently estimate that additional funding of approximately $300 million will be needed over the next five years to carry out required upgrading of office facilities.

34.34 Recent renovation projects indicate that significant savings are possible through increasing the use of Crown–owned space so that less space must be leased. Further savings can result from the lower operating costs of updated mechanical, electrical, heating and ventilation systems.

34.35 The Treasury Board recently expressed concern over the rising costs of office accommodation. Exhibit 34.6 shows that expenditures on office facilities increased from about $740 million in 1989–90 to $1,079 million in 1993–94. The Board has directed the Department to develop a multi–year plan for achieving a 10 percent saving in both the amount of office space and the overall cost of the accommodation program over the next five years.

Exhibit 34.5

Profile of Crown–owned Office Buildings

Building Age	No. of Buildings	Office Space	
		Square Metres	Percentage
1 – 10 years	18	63,291	3
11 – 20 years	37	707,418	31
21 – 30 years	44	397,723	17
31 – 40 years	134	584,219	25
41 years and over	134	568,334	24
	367	2,320,985	100

Source: 1993 Public Works and Government Services data

Impact of government accounting policies on capital expenditures

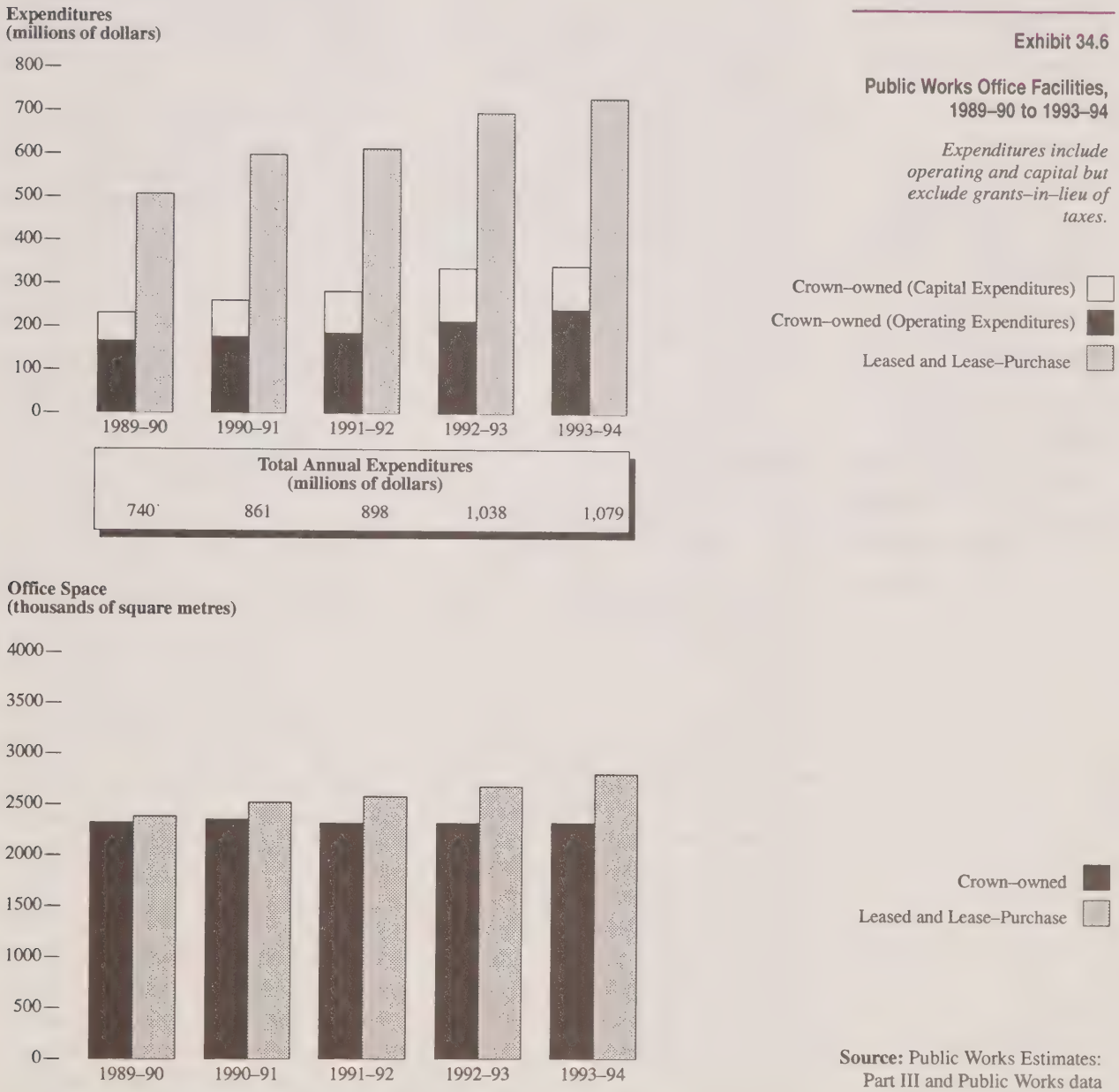
34.36 Government budgeting and accounting policies treat both capital investment and operating costs as expenditures for purposes of calculating the annual deficit; the arrangement places proposed capital investment projects at a disadvantage during budget deliberations.

34.37 For example, no distinction is made between a $25 million outlay to renovate a building and a yearly $4 million outlay to lease equivalent space in a private building, even though the two types of expenditures are fundamentally

Exhibit 34.6

Public Works Office Facilities, 1989–90 to 1993–94

Expenditures include operating and capital but exclude grants–in–lieu of taxes.



Source: Public Works Estimates: Part III and Public Works data

different. The difference is that a capital expenditure for the renovation of Crown–owned buildings will provide future benefits by housing federal employees for perhaps 15 or 20 years, while an annual lease payment will have to be made year after year and will usually result in a higher overall cost to the government. However, because of the immediate needs of deficit management, major capital outlays are being deferred.

A realistic strategy for minimizing risks in the current environment of uncertainty and government downsizing would focus on the retention of essential Crown–owned buildings and attractive long–term leases, based on a region–by–region analysis.

34.38 Departmental officials indicated that Treasury Board Secretariat has discouraged funding proposals for building renovation and space optimization projects unless they are required for health and safety reasons or have short payback periods. This situation has clearly hampered the Department's ability to obtain funding for space optimization projects that could result in substantial savings to the government over the longer term.

Accommodation planning in a rapidly changing environment

34.39 Public Works, like other large facility managers in both the public and private sectors, faces a major challenge in trying to forecast the office space needs of the federal government and to devise an appropriate strategy to respond to these demands in a cost–effective way.

34.40 Despite significant difficulties in the current context of change and uncertainty, we believe that a strategic approach is necessary to provide a framework for making capital investment and disposal decisions on federal buildings and for entering into leases. To be effective, such a strategy must be carried out in close collaboration with the Treasury Board Secretariat and with the departments and agencies that require office space.

34.41 The Department has begun developing community–based investment strategies, but they have been generally limited to only its own holdings, with emphasis on office facilities. Broader–based regional plans that encompass all federal real property are the responsibility of the Bureau of Real Property and Materiel within Treasury Board. The Bureau needs to intensify its collaborative efforts with Public Works and other government custodians of real property to develop regional real estate plans.

34.42 To minimize risks in the current environment of uncertainty and government downsizing, a realistic strategy would focus on the retention of essential Crown–owned buildings and attractive long–term leases, based on a region–by–region analysis. The strategy would also necessitate decisive action to dispose of facilities that are no longer required or suitable for program purposes.

34.43 The proposed strategy should set out the desired mix, by region, of Crown–owned and leased space to meet office space requirements. Owning a building is generally considered less expensive over the long term than leasing it. However, leasing space offers flexibility when the long–term need for a building is uncertain or subject to fast–changing program requirements. A mix of "core" Crown–owned and "support" lease space would thus provide a trade–off or balance between cost and flexibility. There should not be a national "target" ratio; instead, an appropriate balance should be sought to meet the specific needs of each area of the country.

34.44 A more detailed accommodation plan would also be necessary to identify funding requirements for renovating the Crown–owned inventory and to indicate the savings expected through lower

operating costs in the renovated buildings and through reduced leasing requirements. Without such an accommodation plan, there is limited assurance that appropriate decisions will be made in managing, investing and disposing of federal buildings or entering into long–term leases.

34.45 We recognize that preparing accurate forecasts of tenants' space requirements is a most difficult task, but we believe this is the opportune time for the Department to develop an appropriate strategic approach to the planning and management of office accommodation in collaboration with the key players who share this responsibility – the Treasury Board and federal departments and agencies.

Public Works' National Investment Strategy

34.46 Recognizing the need to develop a sound long–range property planning process, the Department recently issued the National Investment Strategy. Approved by Treasury Board in June 1994, the Strategy establishes the objectives, guiding principles and overall direction for all real property investment activities within the Real Property Program. The key principles of the Strategy are as follows:

- Invest in or divest of real property interests to achieve the best use of scarce resources.
- Plan and manage real property interests to meet client needs and minimize life–cycle costs.
- Retain only those interests in real property needed for approved program purposes.
- Base investment decisions on competent and comprehensive analyses of all reasonable options, addressing all financial and non–financial considerations.
- Establish appropriate performance indicators to monitor and evaluate investment decisions and interests.
- Take advantage of the full range of financing alternatives and opportunities for strategic alliances.

34.47 Although the objective of the National Investment Strategy is to plan and manage things better, the Department still has a long way to go to operationalize the concepts described above. Its success in implementing the Strategy will depend on the co–operation of Treasury Board and tenant departments, as well as on its own effectiveness in forecasting the future and meeting the needs implicit in those forecasts.

34.48 We believe that if the National Investment Strategy is appropriately implemented, bearing in mind the suggestions in this chapter, substantial improvements can be achieved.

34.49 The National Investment Strategy contains the following directions pertaining to office facilities:

- Reduce the total inventory to respond to the expected reduction in the demand for space over the next several years.
- Identify and dispose of facilities that do not warrant renovation or retention and make the most of opportunities to reduce costs and improve service to tenants.
- Ensure flexibility by having an appropriate balance of Crown, lease–purchase and lease holdings, taking into account life–cycle cost/benefit analyses.
- Bring Crown facilities up to full environmental, health, safety and accessibility standards as quickly as possible, subject to resource availability.

The Department recently issued the National Investment Strategy, which establishes the objectives, guiding principles and overall direction for all real property investment activities within the Real Property Program.

- Wherever practical, minimize the need for costly retrofits of both Crown–owned and leased facilities.

34.50 In conclusion, much remains to be done to improve the management and planning of federal office accommodation. We believe that the Department is "on the right track". However, it is too early to tell what results will be achieved from implementing the National Investment Strategy.

34.51 Public Works should take into account the impact of the heritage policy on its buildings in developing its long–term facilities plans.

Department's response: *Consistent with the principles of the National Investment Strategy (NIS) (approved by Treasury Board, 23 June 1994) and the Real Property Branch Asset Performance Monitoring Policy (issued in April 1994), the custodial responsibilities under the government's heritage policy are acknowledged, understood and incorporated into the current asset management planning processes. In all future long–term facilities planning, Public Works and Government Services Canada (PWGSC) will identify, where possible, the full impact (cost and/or facility use constraints) of the requirements under the heritage policy for all capital and operating decisions.*

34.52 The government should revise its current budgeting and accounting processes to remove the bias against capital expenditures and to take advantage of the long–term benefits of capital investments.

Treasury Board Secretariat's response: *The Treasury Board Secretariat recognizes that the use of the annual deficit target as the government's principal tool for fiscal management frequently results in a bias against capital investment. Because of this bias, and in order to provide better accounting for the "cost" of government and to improve accountability for assets, the government is seriously studying capitalization of assets as an accounting policy. The study is also addressing negative aspects of a capitalization policy such as administrative cost of implementation and potentially weakened fiscal stewardship. A decision is expected in 1995.*

34.53 The Treasury Board, Public Works and Government Services, and other federal departments and agencies should ensure that accommodation planning is better linked to government program plans, such as restructuring initiatives and regional investment plans. Accommodation planning should be carried out in close collaboration with the key players who share this responsibility. An appropriate balance should be sought in major areas of the country between core Crown–owned buildings and the flexibility offered by leased space.

Department's response: *It should be noted that recently PWGSC has successfully undertaken a series of activities to better integrate long–term accommodation planning with strategic initiatives of government and individual departments. These activities have included the development of a comprehensive strategy to effectively manage the accommodation impact of government restructuring (June and November 1993) particularly in the National Capital Region. This particular activity involved collaboration with the Privy Council Office, Treasury Board Secretariat and senior officials of all affected departments. The resultant PWGSC proposal was approved by the Treasury Board on 2 August 1994 and, when fully implemented, will mitigate costs by some $20 million per annum and realize reductions in space utilization by approximately 78,000 square metres. PWGSC has also been recognized as a major stakeholder in the emergence of*

government initiatives such as the implementation of the Canada Business Service Centre concept, the InfoCentre initiative and the Income Security Program Re–Design. PWGSC was an active member of the interdepartmental task forces and identified real property issues associated with the planning, funding and implementation of these initiatives.

PWGSC will continue the improvement of its accommodation planning processes and further strengthen linkages to government initiatives in connection with the development of a strategy to achieve a 10 percent reduction in the overall use of government office accommodation. The strategy will consider the development of long–term tenant accommodation plans and will address the impact of government programs and policy reviews. It is expected that the strategy will be ready for Treasury Board consideration in connection with the 1995–96 Multi–Year Operational Plan and program review initiatives.

The Department's National Investment Strategy, used in conjunction with the long–term tenant accommodation plans and community investment planning, will ensure that the appropriate space solutions are analyzed and delivered to allow the effective delivery of tenant programs while minimizing the cost of government.

Office Building Operations

34.54 The following sections describe our findings in the operation of Crown–owned office buildings.

Services to tenants

34.55 In recent years, Public Works has developed a number of initiatives and focussed increased efforts on serving tenant departments. Tenant consultation workshops in 1993 showed that, in general, tenants are satisfied with the Department's responsiveness to daily building operations and maintenance problems. However, the 1993 workshops and other studies have shown that there are still problems with respect to consistency of tenant services, timeliness and efficiency of major projects, reporting to tenants and the costs of some services. Our observations support these findings.

Impact of budgetary restraints

34.56 The need for major building maintenance and renovations is reaching a peak at a time of rising concerns about the federal deficit. In response to these concerns, maintenance and capital budgets have been restrained. This can lead to serious problems. Without proper maintenance, facilities will deteriorate to the point that extensive investment is required to restore or replace them. The result, ultimately, will be increased federal costs.

The need for major building maintenance and renovations is reaching a peak at a time of rising concerns about the federal deficit.

34.57 According to Public Works officials, fiscal restraint over the past ten years has prevented the Department from undertaking the major maintenance and renovations required to keep its asset base current and at industry standards. They estimate that they would need capital funding of approximately $300 million over the next five years to accomplish this task. As noted earlier in the chapter, in the section entitled "Impact of government accounting policies on capital expenditures", the government's own accounting policies tend to favour operating expenditures over capital spending because it has a less immediate impact on the deficit. Further, without a long–term facilities plan, the Department cannot establish appropriate maintenance and repair priorities to manage and safeguard the value of its buildings.

Asset management plans

34.58 The results of our audit indicate that Public Works and Government Services does not compile and consolidate sufficient information on the condition of its buildings to adequately identify its total capital and repair needs.

34.59 About five years ago, the Department began preparing asset management plans for each Crown–owned office building. The purpose of these plans was to provide a strategic framework to guide portfolio management decisions. The plans were to include a comprehensive, in–depth analysis of each building, including the identification of operation and maintenance requirements and capital expenditures.

34.60 To date, this exercise has cost the Department about $5 million, principally on external consultants. Our review of a sample of the asset management plans showed that they varied considerably in quality and substance. Some plans contained detailed assessments of the major building components and detailed estimates of the cost of needed maintenance and repairs. In other cases, however, the analysis of operating costs was inadequate because information on building conditions and operating costs was limited. We also found that no meaningful summaries of repair and maintenance backlogs had been prepared for the use of senior Public Works managers, for Treasury Board or for Parliament.

34.61 As new information systems are developed, the Department intends to update its asset management plans and correct these deficiencies so that the new plans will yield the type of information the Department needs to manage its portfolio of Crown–owned office facilities.

Preventive maintenance

34.62 An effective maintenance management system includes the following components:

- periodic inspection and assessment of building conditions;
- work standards for operating and maintaining major building systems and components;
- priority setting, budgeting and work scheduling; and
- management reporting on work performance.

34.63 A good maintenance management policy is based on asset categories that are compatible with long–range facility plans. The benefits of a good preventive maintenance program include increased service life of the facility, early identification and correction of deficiencies, and lower operating costs over the life cycle of the facility. The quality of the maintenance and repair of federal office buildings has a direct impact on the productivity of employees, public health and safety, and the cost–effective use of government assets.

34.64 Public Works introduced its Facilities Inspection Program in 1976. Maintenance routines and schedules were further refined and automated in 1986–87 with the implementation of the Preventive Maintenance Support System.

34.65 This system provides a formal program of scheduled inspections to service and test building systems and to identify maintenance deficiencies. The inspections and preventive maintenance routines are conducted by in–house building staff, tradespeople and technologists or private sector contractors. Property managers recommend the appropriate level of preventive maintenance on the basis of advice from the District Head, Technical Services.

34.66 Preventive maintenance for health and safety is obligatory. The Asset Manager in the Real Property Branch may choose from two other levels of preventive maintenance offered by the Realty Services Branch: basic upkeep of critical operating equipment and an enhanced level that includes all building components.

34.67 We found that practices varied from complete implementation of the Preventive Maintenance Support System in some regions to the use of a totally different local system in one region.

34.68 From a 1992 internal review of maintenance practices in the National Capital Region and our own audit, we noted that although minimum health and safety requirements were described, the following problems existed:

- There was no departmental policy on the appropriate level of maintenance for federal office facilities, and there were no policies and guidelines on the use of the Preventive Maintenance Support System.
- Except for the maintenance of life safety equipment, the use of the system was optional; the choice was left to individual asset managers and property managers.
- Major users and operators of the system had not received adequate training.

34.69 The Department intends to acquire a new, up–to–date maintenance management system. We believe, however, that the Department needs to resolve the problems associated with the old system before implementing a new one.

34.70 Conducting regular building inspections with appropriately trained technical staff is necessary to compile the information needed to plan and implement an effective maintenance program. In the absence of such a program, it is difficult to develop reasonable repair and maintenance budgets and make decisions on the division of resources between capital projects and maintenance operations.

34.71 Because of the emphasis on meeting short–term financial performance targets (contribution margins) in the management of Crown–owned buildings, some property managers are conducting annual building inspections without using the services of the Technical Services Division. Since property managers have very little control over other building operating costs, avoiding the use of technically qualified staff in conducting annual building inspections is one of the few ways in which they can reduce their costs and thus improve their financial performance over the short term.

34.72 We found that no clearly established quality control program existed to ensure "due diligence" on matters related to health, safety and operating requirements. In addition, some managers were not clear on accountabilities for these critical aspects of building management.

34.73 In summary, the preventive maintenance philosophy in the Department appeared to be inconsistent; it ranged from a proactive life–cycle approach to a reactive "wait until it breaks down" maintenance approach. In our opinion, the Department needs to ensure that appropriate maintenance standards, based on sound public and private sector practices, are in place and consistently applied in all regions.

The preventive maintenance philosophy in the Department appeared to be inconsistent; it ranged from a proactive life–cycle approach to a reactive "wait until it breaks down" maintenance approach.

Energy and water conservation in Crown–owned buildings

34.74 Canada's *Green Plan*, announced in 1990, was developed to provide a framework to assess the environmental

issues facing our nation and to develop and implement solutions to these issues. The Plan recognizes that the public expects the federal government to show leadership in environmental matters and commits the government to the adoption of a Code of Environmental Stewardship. Under the Code, federal departments are pledged to develop environmental action plans that address, among other things, energy and water conservation.

34.75 Due to the size and extent of Public Works' real property portfolio, the Department's operations have the potential to make a significant impact on our environment. In our audit of Crown–owned office facilities, we examined energy conservation initiatives and briefly surveyed water conservation measures.

34.76 In December 1992, Public Works issued its Environmental Management Plan and began a process of assessing all departmental operations to determine how it could carry out its mandate in a more environmentally responsible manner. As well, the initiatives put forward by the *Green Plan* were considered to ascertain their relevance to Public Works, and strategies were developed to address the relevant issues. The result of both these undertakings was a series of pledges outlining how the Department intends to address 26 important environmental issues.

34.77 The Federal Buildings Initiative for improvement of energy efficiency and conservation. One important vehicle for improvement of energy efficiency and conservation is the Federal Buildings Initiative. In February 1992, the Department of Natural Resources introduced the Initiative to provide custodian departments with the opportunity to realize the benefits of improved energy efficiency. Under the program, private sector firms, known as energy service companies, finance the capital requirements to retrofit government–owned properties to make them more energy–efficient.

34.78 One feature of the Initiative is performance contracting with a third–party financing mechanism that enables departments to undertake required energy efficiency improvements or to retrofit their buildings' mechanical and electrical systems. It should be noted that this is not necessarily the least–cost option for replacing or acquiring capital equipment and ultimately may cost more than direct government funding of a retrofit or replacement. However, the cost of the work and the related savings are guaranteed, a condition not available to retrofits directly implemented by the government.

34.79 Under the Initiative, a department requests preliminary proposals in a competitive–bid process from at least three energy service companies that have been pre–qualified for such work. Negotiations are then held with the company selected and a contract signed to undertake the retrofit or replacement. The capital costs are financed by the company and repaid from the energy savings realized as a result of increased energy efficiency due to the retrofit or replacement. The contractor guarantees the department a certain level of savings based on the building's current energy consumption, and the pay–back period (maximum of eight years) is established in the contract. Total energy costs are no higher than the current costs and, at the end of the pay–back period, the department benefits from reduced energy costs. The contract also specifies the adjustments that will be made to reflect inflation and changes in energy consumption not related to the project.

34.80 According to estimates prepared by the Department of Natural Resources, the federal government could save about $100 million a year on energy costs through the Federal Buildings Initiative. Public Works estimates that its potential share of these annual savings is between $12 and $15 million.

34.81 In addition to the potential for significant dollar savings, improving energy efficiency in federal buildings would make an important contribution towards achieving Canada's goal of stabilizing emissions of carbon dioxide and other greenhouse gases.

34.82 According to Public Works officials, there are about 80 Crown–owned office buildings that are suitable candidates for the Initiative. To date, Public Works has implemented one energy saving project on the Harry Hays Building in Calgary, Alberta, (see Exhibit 34.7) and is in the process of negotiating contracts for three other buildings.

34.83 Water conservation. Many of the principles employed in the energy conservation program are directly applicable to water conservation. Indeed, departments considering an upgrade to their facilities could simultaneously implement energy and water conservation measures. The Department of the Environment estimates that $30 million a year could be saved by improving the efficiency of water use in all federal facilities.

34.84 During 1993, the Environmental Services Division in Public Works conducted an audit of 116 of the Department's Crown–owned buildings across Canada. A February 1994 report concluded that energy and water audits had not been conducted at most facilities and that strategies for energy and water conservation had not yet been defined by Public Works.

34.85 Our discussions with officials at Public Works and the departments of Natural Resources and the Environment, along with our own observations, confirmed the need for Public Works to assess the results and risks of its pilot energy and water conservation projects and to plan similar measures in other suitable buildings.

34.86 The Department should:

a) develop a plan to provide more stable funding for major maintenance and renovation of its buildings;

b) be certain that it has appropriate management information on asset condition, building costs and performance, and the consolidated requirements for repairs and maintenance;

c) ensure that appropriate maintenance standards are in place and consistently applied in each region; and

According to estimates prepared by the Department of Natural Resources, the federal government could save about $100 million a year on energy costs through the Federal Buildings Initiative. Public Works estimates that its potential share of these annual savings is between $12 and $15 million.



Exhibit 34.7

Federal Buildings Initiative Project: Harry Hays Building, Calgary, Alberta

In 1993, the Pacific Western Region implemented its first Federal Buildings Initiative project in the Harry Hays Building. The project cost of approximately $1.6 million is being financed by a private sector energy service company. This will be repaid by Public Works over a maximum of eight years through the energy savings achieved. These savings result from a reduction of energy costs of $270,000 per year. Once the project cost has been repaid, these savings will accrue to the Department. The Department expects to realize additional savings through the lower operational and maintenance costs of the upgraded energy systems.

d) assess the results and risks of its pilot energy and water conservation projects and, where appropriate, implement similar measures in other suitable buildings as quickly as possible.

Department's response:

a) The National Investment Strategy and the 1995–96 Multi–Year Operational Plan submission relative to the capital plan of the Real Property Program identify the requirement, and necessary funding levels, to deliver a program of renovating Crown–owned assets (office and common–use) at a rate of 4 percent per year. The ability to be successful in the delivery of this plan is directly related to the acquisition of the necessary incremental funds.

b) PWGSC, through its Asset Management Plan Policy and Building Management Plan process, has identified the management information required to appropriately manage the assets under its custodianship. What has been lacking to this point are effective management information tools. The tools (the Asset Planning and Asset Management systems) have been identified as business–critical in the departmental strategic information technology plan and are planned for development in the coming years as resources can be made available.

c) The Department is taking steps to enhance the quality of maintenance standards and their application across the country. The steps include: i) health and safety: safety requirements checklist and associated policy and periodic audits; ii) environmental regulatory and health and safety requirements: managerial framework including project prioritization, funding, implementation, audit and verification and reporting; iii) a workplan for maintenance with prudence and probity.

d) For both energy and water conservation, we now have existing processes that will allow us to take maximum advantage of existing opportunities. For example, the identification of savings possibilities has been incorporated directly into our annual building management planning process. In this fiscal year alone, we intend to initiate up to 25 Federal Buildings Initiative projects. Any quicker progress would not be consistent with the principle of prudence.

Accountability and Incentives

Accountability of tenant departments for office accommodation

34.87 Should government departments pay rent for accommodation? In our 1991 chapter on leased office space, we observed that the fundamental question of whether government departments should pay rent for office accommodation was unresolved. At the time of writing this report, the question is still unanswered.

34.88 In 1991, we recommended that Public Works seek government resolution of the question of charging tenant departments for office accommodation. In 1994, the Treasury Board Secretariat was asked by ministers to examine this issue and develop implementation options in consultation with Public Works and Government Services and other departments. In our view, resolution of this fundamental issue is urgently needed to facilitate essential reforms in planning and managing office accommodation.

34.89 User–pay systems for government accommodation are complex, and practices vary markedly within

Canada and in other countries. Moreover, the concept of user pay has its supporters and opponents, depending upon various definitions of "good public administration".

34.90 With a user–pay system, tenant departments would receive appropriations from which they would pay rent to Public Works, based on the estimated market rate for space occupied.

34.91 Charging for accommodation has usually been a key element in past attempts to establish revenue dependency for Public Works. As the wording suggests, Public Works would depend on revenues generated from providing accommodation and other services to finance all of its activities, including capital repairs and acquisitions.

34.92 In 1985, the Nielsen Task Force on Program Review noted: "Instead of revenue dependency becoming an initiative to reform Public Works, it has become a vast exercise in financial and information system development." The Task Force observed:

> "Revenue dependency has been oversold by its advocates....it is not a panacea for Public Works or government accommodation problems. It will not be very effective in controlling the demand of tenants for services. The money tenants will need for services and rental accommodation will, in most cases, come from appropriations and be "passed through" to Public Works. Displaying accurate accommodation costs in departmental estimates is unlikely to improve discipline because such costs are so minor an element of departmental budgets. In the United States, Great Britain and the two Canadian provinces using Crown corporations to deliver accommodation, control of tenant demands is still exercised by versions of entitlement standards, enforced by central agencies."

34.93 Supporters of user pay for accommodation claim that departments would be more aware of the cost of accommodation and would therefore restrain their space demands in terms of location, quality and quantity.

34.94 Opponents of user pay argue that to introduce the concept without giving tenant departments "optionality" – the freedom to choose their own office space – and without forcing Public Works to compete with the private sector would simply add to the administrative process and create little overall savings in accommodation. Accommodation costs would merely be passed through to the tenant departments, using an elaborate accounting and billing system.

34.95 A further problem is that optionality is generally considered unworkable in areas where the federal government is a dominant user of office space, such as the National Capital Region. Public Works and Government Services holds 42 percent of its Crown–owned office space and 45 percent of its leased office space in the National Capital Region. In such a market, one common service provider (Public Works) who knows the local real estate market can deal most effectively with private sector real estate firms (the supply side) and optimize tenant requests (the demand side) with the available Crown property holdings. In our opinion, optionality for accommodation in the National Capital Region would be impractical and very likely lead to suboptimizing government resources for accommodation.

34.96 According to Public Works and Government Services officials, jurisdictions that have introduced optionality have suffered from an exodus to more attractive leased space and

consequently have large inventories of vacant public sector buildings, which are difficult to rent out or to dispose of in glutted markets. Since the changes in real property organization in most jurisdictions are relatively recent, it is too early to fully evaluate their impact. Public Works continues to monitor the pros and cons of these organizational changes in Canada and abroad.

34.97 In 1988, when it was decided to transfer the administration of accommodation policies to Public Works, Treasury Board decided to defer consideration of the issue of charging rent to all departments until the end of the implementation process. Treasury Board will evaluate Public Works' increased managerial control of the accommodation program and assess the viability of user pay for accommodation. The evaluation had not yet been conducted at the time of writing this report.

34.98 In our 1991 chapter on federal government building leases, we concluded that:

> "The revenue dependency concept can work for common service agencies in some situations, but it is not a panacea. These agencies invariably require good management practices, appropriate management information systems, adequate controls and realistic performance measurement systems no matter how they are organized or how their services are financed."

34.99 We still hold to our conclusion for revenue dependency and the related practice of user pay for accommodation.

34.100 Monitoring departmental space usage and providing better performance information. For many years, Public Works has been responsible for monitoring compliance with Treasury Board policies on the amount, quality and location of office accommodation for tenant departments. In its control role, the Department must ensure that requests for space are met with optimal use of existing inventory (Crown–owned and leased), best value for money and integrity in the tendering process.

34.101 In September 1993, the responsibility for the development and enforcement of office accommodation policies was transferred to Public Works and Government Services. Under the new framework, called Shared Accommodation Leadership, the Department is working in partnership with tenants to establish benchmarks and standards for office accommodation (see Exhibit 34.8).

34.102 Concurrent with the establishment of this framework, the Treasury Board directed the Department to develop a comprehensive plan, in consultation with tenants and Treasury Board, to achieve a 10 percent reduction in the amount of accommodation used by the government.

34.103 The framework offers tenant departments certain choices: it enables them to take a lead role in defining their accommodation requirements and to be accountable for how their space is used. In addition, tenants are able to negotiate exceptions to standards but are required to pay for those exceptions.

34.104 Since 1963, Public Works has been showing the imputed value of accommodation provided without charge to tenant departments. Despite the disclosure of this information, it is generally recognized that since the space is free to most departments, there are few strong incentives for them to limit their use of space. For example, there is no

disclosure of space usage against a baseline standard.

34.105 In our opinion, there has to be more "bite" to the accountability system for tenant departments. This might include, for example, a self–assessment or self–monitoring system to ensure that each tenant keeps its space within a predetermined range.

34.106 Public Works and Government Services has an important regulatory role at a macro–level in the central management of government accommodation. However, it is impractical and too expensive for the Department to monitor tenant departments at a micro–level. Departments have to provide accurate occupancy information to Public Works and periodically validate information on their space usage.

34.107 Our 1991 audit of leased office space, externally prepared asset management plans and departmental internal studies have noted the problems with the Department's property management information. Our observations from this audit reaffirm that there is still a need for better property management information, including tenant occupancy data.

34.108 To monitor the current use of space by each tenant, Public Works and Government Services prepares summary accommodation performance reports using three indicators: square metres per person, costs per square metre and costs per person. (In this context, "costs" are imputed market–based rents, not actual cash expenditures.) Public Works and Government Services has provided this information to tenant departments as of March 1994 and intends to publish the performance indicators along with external benchmarks, by tenant department, in its 1995–96 Estimates. We support this initiative to report accommodation information to Parliament and encourage the Department to report actual expenditures by tenant department, as well.

In our opinion, there has to be more "bite" to the accountability system for tenant departments.

Accountability within Public Works for managing buildings and projects

34.109 The present accountability structure in Public Works dates back to 1986 and is based on the recommenda-

Exhibit 34.8

Shared Accommodation Leadership

Public Works' "Shared Accommodation Leadership" (SAL) is the latest initiative designed to improve accountability for office accommodation. SAL sets out the responsibilities as follows:

Public Works and Government Services:

- has the mandate and is accountable for allocating all office space to its tenant departments;
- is accountable for effectively acquiring and managing office space; and
- will develop, maintain and apply benchmarks and performance indicators on the use of accommodation.

Tenant departments:

- are accountable for planning and using office space effectively and efficiently.

Public Works and tenants:

- will share accountability through a Master Occupancy Agreement that outlines space standards for their requirements, a framework for accountability, performance indicators and reporting requirements.

tions of the Nielsen Task Force. In order to operate the Real Property Program in a more "businesslike manner" and improve accountability, a buyer–seller relationship was established between the Real Property Branch and the two services branches, Realty Services and Architectural and Engineering.

A November 1992 operational review by external consultants and our own audit work have found that there is an excessive amount of complexity involved in the day–to–day management of Public Works.

34.110 Officials of the Real Property Branch, the custodian of office and certain other government facilities, believe they are accountable for those facilities and that the service branches should provide them with services, as would any third–party supplier. They pointed out, however, that, unlike owners/investors in the private sector, they do not have the option to use other suppliers if they are not satisfied with the internal service branches. They also stated that a quality assurance program is not in place to ensure that the branches comply with the terms of internal service contracts. In brief, they believe that a more businesslike approach with an arms–length relationship is needed.

34.111 Departmental and interbranch charging for realty, architectural and engineering services was initiated to encourage cost awareness on the part of both tenant departments and the Real Property Program within Public Works and Government Services.

34.112 The application of the buyer–seller model within Public Works has contributed to the establishment of a complex system of interbranch service agreements, memoranda of understanding and internal charging practices. Rather than making the Department more businesslike and clarifying accountability, it has had the opposite effect, diverting efforts from managing buildings to managing internal processes. In particular, it has made the departmental programs bureaucratic and costly to administer. Departmental officials cited the following problems:

- the tendency to defer repairs and maintenance to improve the short–term financial performance of buildings;
- unproductive internal competition between service branches in the face of a shrinking workload; and
- excessive internal paperwork and complicated administrative processes.

34.113 Internal audit reviews of cost overruns on recently completed building renovation projects concluded that project problems were partly attributable to overlap, duplication and confusion over the roles and responsibilities of the Real Property Branch, Realty Services Branch and the Architectural and Engineering Branch.

34.114 Recent client surveys and client consultation workshops indicated that clients still felt that too many people were involved in certain projects and, often, it was unclear who was in charge. For example, respondents to a survey conducted in one of the regions stated that "more work needs to be done in this area in order to ensure that there is true accountability of the Real Property Branch personnel for all services provided by Public Works and that this accountability is recognized and supported by the other branches in the region, that is, by the Realty and Architectural and Engineering Branches."

34.115 A November 1992 operational review by external consultants and our own audit work have found that there is an excessive amount of complexity involved in the day–to–day management of Public Works. According to estimates provided in the review, annual savings of $12 million could be achieved through

reduction and simplification of administrative practices.

34.116 We observed that in regions where Public Works branches generally co–operated with each other and worked toward a common goal, it was reflected in operational results. There were fewer problem projects, less chance of duplication of services and a sense that technical specialists were consulted when they were needed. In brief, the commitment to providing office accommodation and to serving tenant departments encouraged staff to better manage interbranch activities.

34.117 We believe that the moment is opportune to examine once again the assumptions that underlie the structural and operational changes that have been implemented over the past decade.

34.118 The re–examination should include the roles, responsibilities and accountabilities of the current branches of Public Works. In June 1994, the Deputy Minister appointed a task force to study the organization of the Public Works branches. The task force is expected to submit its preliminary recommendations by the fall of 1994.

34.119 The government should address the fundamental accommodation issue of whether departments should pay rent for accommodation and the question of whether to give departments greater freedom to choose their own office space.

Treasury Board Secretariat's response: *The government is actively re–evaluating the issue of user pay for office accommodation. Until now, the government has made a conscious decision not to implement such a system for office accommodation due to the need to resolve the complexities and issues that are raised by the Auditor General. It should be noted that all special purpose accommodation has always been subject to a user pay regime.*

Department's response: *The issue of corporate autonomy and control over accommodation costs as for other overhead items of government programs – such as salaries, telecommunications – is a fundamental issue of governance. The question is whether the government–wide goals of cost containment and broader objectives are best met through centralized or decentralized control. Government in Canada has made decisions on both sides of this issue. Arguably, where standards and reporting exist, the value added of user pay is doubtful. PWGSC has committed to reporting to the Treasury Board Secretariat on the feasibility of user pay for accommodation following its assessment of the success of Shared Accommodation Leadership (SAL), which is in the early stages of implementation. SAL provides tenant departments with greater degrees of flexibility and choice related to accommodation standards (and therefore satisfaction) together with greater accountability for the consequences of choice. Treasury Board Senior Advisory Committee and Treasury Board endorsed SAL as a valuable incremental step towards the evaluation of user pay.*

34.120 The government should ensure that tenant departments are held accountable for the efficient use of their office space.

Department's response: *The Shared Accommodation Leadership policy framework developed by PWGSC clearly states that tenants are accountable for the efficient use of space during occupancy and share a responsibility for the identification of space optimization opportunities. (The development of space optimization strategies will be led by PWGSC, in consultation with the tenant department.) PWGSC is attempting to increase tenant sensitivity to their accountability for space use by annually*

communicating and publishing key indicators on tenant accommodation utilization and to ensure that this utilization is consistent with normative benchmarks for other organizations with comparable operational requirements. Consideration will be given to the re–affirmation of the principle of tenant accountability for the use of office space in connection with the development of the strategy to achieve a 10 percent reduction in accommodation.

34.121 Public Works and Government Services should:

a) make certain that its various branches co–operate and co–ordinate their work to provide office accommodation and service to departments, with clear and consistent delineation of staff roles and responsibilities and project leadership; and

b) in carrying out initiatives to simplify and reduce the costs of its services and administrative practices, improve its management information on departments' use of space.

Department's response:

a) A current organizational review is identifying ways and means of re–engineering the Public Works components of the Department in a manner which makes it more efficient and clarifies lines of accountability. Project roles and responsibilities will be re–examined within the new framework of accountabilities.

b) PWGSC has realized considerable progress over the last few years through a concerted effort to improve the quality of management information captured in its accommodation information system.

As noted, PWGSC will formally publish key indicators on tenant use of accommodation in the 1995–96 Estimates (Part IIIs). PWGSC experience has been that tenants have acknowledged the criticalness of this information and have attached a high priority to ensuring data accuracy. It is the intention of PWGSC to publish this information on an annual basis and therefore initiate a systematic annual validation of the accuracy of tenant information contained in departmental accommodation inventory management systems. It is felt that the sensitivity and visibility of this data is such that departments will ensure that the PWGSC information continues to reflect current and accurate information.

PWGSC also has under way systems initiatives to upgrade management of tenant demand (implementation beginning September 1994) and occupancy agreements (implementation in 1995). It is expected that the implementation of these systems will significantly enhance the capacity of the Department to effectively and efficiently manage information on departments' use of space by making the information readily accessible to all real property officers through a direct automated interface with the data base.

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